1 or 2 of Boeing Service Bulletin 727-32-0383, dated December 6, 1990; or Revision 1, dated January 30, 1992.

(1) If Figure 1 of either service bulletin is accomplished, repeat the inspection required by paragraph (c) of this AD at intervals not to exceed 3,700 flight cycles or 3 years after the immediately preceding inspection, whichever occurs first.

(2) Accomplishment of Figure 2 of Revision 1 of the service bulletin (for all bolts); or accomplishment of Figure 2 of the service bulletin dated December 6, 1990 (for bolts 1 and 2) and accomplishment of a torque check of bolt 3 in accordance with Revision 1 of the service bulletin; constitutes terminating action for the inspection requirements of paragraph (c) of this AD.

(e) For airplanes that have not previously accomplished the actions required by paragraph (a) of this AD prior to the effective date of this AD: Prior to the accumulation of 1,500 flight cycles after the effective date of this AD, or within 18 months after the effective date of this AD, whichever occurs first; and thereafter at intervals not to exceed 3,700 flight cycles or 3 years after the immediately preceding inspection, whichever occurs first; inspect the MLG door actuator attach fitting to ensure that serrations are fully mated, and to detect loose bolts, in accordance with Part III, Accomplishment Instructions, of Boeing Service Bulletin 727-32-0383, Revision 1, dated January 30, 1992.

(f) If serrations are not fully mated, or if loose bolts are found as a result of the inspections required by paragraph (e) of this AD, prior to further flight, accomplish Figure 1 or 2 of Boeing Service Bulletin 727-32-0383, Revision 1, dated January 30, 1992.

(1) If Figure 1 of the service bulletin is accomplished, repeat the inspection required by paragraph (e) of this AD at intervals not to exceed 3,700 flight cycles or 3 years after the immediately preceding inspection, whichever occurs first.

(2) Accomplishment of Figure 2 of the service constitutes terminating action for the inspection requirements of paragraph (e) of this AD.

(g) An alternative method of compliance or adjustment of the compliance time that provides an acceptable level of safety may be used if approved by the Manager, Seattle Aircraft Certification Office (ACO), FAA, Transport Airplane Directorate. Operators shall submit their requests through an appropriate FAA Principal Maintenance Inspector, who may add comments and then send it to the Manager, Seattle ACO.

Note: Information concerning the existence of approved alternative methods of compliance with this AD, if any, may be obtained from the Seattle ACO.

(h) Special flight permits may be issued in accordance with FAR 21.197 and 21.199 to operate the airplane to a location where the requirements of this AD can be accomplished.

(i) Certain inspections and replacement shall be done in accordance with Boeing Service Bulletin 727-32-0383, dated December 6, 1990, as indicated. This incorporation by reference was approved previously by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR Part 51 as of September 26, 1991 (56 FR 46112, September 10, 1991). Certain other inspections and replacement shall be done in accordance with Boeing Service Bulletin 727-32-0383, Revision 1, dated January 30, 1992, as indicated. This incorporation by reference was approved by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR Part 51. Copies may be obtained from Boeing Commercial Airplane Group, P.O. Box 3707, Seattle, Washington 98124-2207. Copies may be inspected at the FAA, Transport Airplane Directorate, 1601 Lind Avenue, SW., Renton, Washington; or at the Office of the Federal Register, 800 North Capitol Street, NW., suite 700, Washington, DC.

(j) This amendment becomes effective on February 23, 1993.

Issued in Renton, Washington, on January 11, 1993.

N.B. Martenson,

Acting Manager, Transport Airplane Directorate, Aircraft Certification Service.

[FR Doc. 93-1433 Filed 1-21-93; 8:45 am]

BILLING CODE 4910-13-M

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14 CFR Part 39

[Docket No. 91-NM-220-AD; Amendment 39-8469; AD 93-01-15]

Airworthiness Directives; McDonnell Douglas Model DC-8 Series Airplanes

AGENCY: Federal Aviation Administration, DOT.

ACTION: Final rule.

SUMMARY: This amendment supersedes an existing airworthiness directive (AD), applicable to McDonnell Douglas Model DC-8 series airplanes, that currently requires structural inspections to detect fatigue cracking, reporting of the inspection results, and repair or replacement, as necessary, to ensure continued airworthiness as these airplanes approach the manufacturer's original fatigue design life goal. This amendment requires modification of the existing sampling program to: (a) Require additional visual inspections of all Principal Structural Elements (PSE's) on certain airplanes, (b) include expanded/modified PSE's, (c) revise the reporting requirements, and (d) increase the sample size. This amendment is prompted by new data submitted by the manufacturer indicating that additional inspections and an expanded sample size are necessary to increase the confidence level of the statistical program to ensure timely detection of cracks in PSE's. The actions specified by this AD are intended to prevent fatigue cracking, which could result in a compromise of the structural integrity of these airplanes.

DATES: Effective February 26, 1993.

The incorporation by reference of certain publications listed in the regulations was approved previously by the Director of the Federal Register as of August 10, 1987 (54 FR 25591, July 8, 1987).

The incorporation by reference of certain other publications listed in the regulations is approved by the Director of the Federal Register as of February 26, 1993.

ADDRESSES: The service information referenced in this AD may be obtained from McDonnell Douglas Corporation, P.O. Box 1771, Long Beach, California 90846-1771, Attention: Business Unit Manager, Technical Publications—Technical Administrative Support, C1-L5B. This information may be examined at the Federal Aviation Administration (FAA), Transport Airplane Directorate, Rules Docket, 1601 Lind Avenue, SW., Renton, Washington; or at the FAA, Los Angeles Aircraft Certification Office, 3229 East Spring Street, Long Beach, California; or at the Office of the Federal Register, 800 North Capitol Street, NW., suite 700, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Mike Lee, Aerospace Engineer, Airframe Branch, ANM-122L, FAA, Transport Airplane Directorate, Los Angeles Aircraft Certification Office, 3229 East Spring Street, Long Beach, California 90806-2425; telephone (310) 988-5325; fax (310) 988-5210.

SUPPLEMENTARY INFORMATION: A proposal to amend part 39 of the Federal Aviation Regulations by superseding AD 87-14-06, Amendment 39-5631 (54 FR 25591, July 8, 1987), which is applicable to McDonnell Douglas Model DC-8 series airplanes, was published in the Federal Register on January 15, 1992 (57 FR 1697). The action proposed to require structural inspections and necessary repair or replacement to ensure continued airworthiness as these airplanes approach the manufacturer's original fatigue design life goal.

Interested persons have been afforded an opportunity to participate in the making of this amendment. Due consideration has been given to the comments received.

One commenter supports the proposed rule.

Several commenters request that the AD be issued as a revision to AD 87-14-06, which would retain this same AD number, rather than as a supersedure, which would be given a new AD number. The commenters note that a revision would lessen the chances for a bookkeeping error to occur. The FAA does not concur. The FAA's current policy (reference FAA Order 8040.1B, "Airworthiness Directives") is that, whenever a "substantive change" is made to an existing AD, the AD must be superseded, rather than revised. "Substantive changes" are those made to any instruction or reference that affects the substance of the AD, and includes part numbers, service bulletin and manual references, compliance times, applicability, methods of compliance, corrective action, inspection requirements, and effective dates. In the case of this AD rulemaking action, the changes being made to the existing AD are considered substantive. This superseding AD is assigned a new amendment number and new AD number; the previous amendment is deleted from the system. This procedure facilitates the efforts of the Principal Maintenance Inspectors in tracking AD's and ensuring that the affected operators have incorporated the latest changes into their maintenance programs.

With regard to bookkeeping changes required by affected operators, Federal Aviation Regulations (FAR) § 121.380(a)(2)(v), "Maintenance recording requirements," requires that persons holding an operating certificate and operating under FAR part 121 must keep records "indicating the current status of applicable airworthiness directives, including the method of compliance." Whether an existing AD is superseded or revised, the new AD is assigned a new AD number: A superseding AD is assigned a new 6-digit AD number; a revising AD retains the original 6-digit AD number, but an "R1" is added to it. In either case, the new AD is identified by its "new" AD number, not by the "old" AD number. In light of this, affected operators updating their maintenance records to indicate the current AD status would have to record a new AD number in all cases, regardless of whether the AD is a superseding or a revising AD. Further, operators are always given credit for work previously performed in accordance with the existing AD by means of the phrase in the compliance section of the AD that states, "Required * * * unless accomplished previously."

One commenter requests a revision to the compliance time to accomplish the inspections of those Principal Structural Elements (PSE) that are near or past the end dates by extending it to one year. The commenter notes that the proposed compliance time of six months to incorporate the latest SID revision into an operator's maintenance program is inadequate to accomplish all overdue PSE's without imposing an undue burden on operators. The FAA does not concur with the commenter's request to extend the compliance time. The FAA has determined that the compliance time, as proposed, represents the maximum interval of time allowable for the affected airplanes to continue to operate prior to accomplishing the required inspections without compromising safety. However, under the provisions of paragraph (d) of the final rule, the FAA may approve an alternative method of compliance or adjustment of the compliance time if operators submit sufficient justification to the FAA.

Several commenters note that the process for reporting inspection results needs improvement. These commenters audited the reports from one operator and found over 200 discrepancies in appendix C of volume III–91 of McDonnell Douglas Report No. L26–011, "DC–8 Supplemental Inspection Document (SID)," dated April 1991, which contains the record of inspection results submitted to McDonnell Douglas Corporation. The FAA does not concur that a change to the AD is necessary. McDonnell Douglas has advised the FAA that it has recognized the occurrence of these discrepancies and has taken steps to correct them and to ensure that they will not occur again. However, under the provisions of paragraph (d) of the final rule, the FAA may approve, on a case-by-case basis, an alternative method of reporting inspection results, if sufficient justification is presented to the FAA.

One commenter requests that proposed paragraph (b), which references only section 2 of volume I of the SID for those PSE's that need to be inspected, be revised to include section 3 of volume 1, since PSE's related to previous AD's are defined in section 3. The FAA concurs. Paragraph (b) of the final rule has been revised accordingly.

One operator requests that proposed paragraph (c) be revised to delegate approval of repairs to Designated Engineering Representatives (DER) of the McDonnell Douglas Corporation, since this operator has experienced delays and additional costs in obtaining approval of repair data by Aircraft Certification Office (ACO) managers. The FAA does not concur. While DER's are authorized to determine whether a design or repair method complies with a specific requirement, they are not authorized to make the discretionary determination as to what the applicable requirement is. Further, it is crucial that the FAA, as well as McDonnell Douglas, be aware of all repairs made to PSE's or to their configuration, and that damage tolerance analysis be performed for each repair to establish its effect on the fatigue life of the affected structure.

Paragraph (d) of the final rule has been revised to clarify the procedure for requesting alternative methods of compliance with this AD.

After careful review of the available data, including the comments noted above, the FAA has determined that air safety and the public interest require the adoption of the rule with the changes previously described. The FAA has determined that these changes will neither increase the economic burden on any operator nor increase the scope of the AD.

There are approximately 337 Model DC–8 series airplanes of the affected design in the worldwide fleet. The FAA estimates that 222 airplanes of U.S. registry and 15 U.S. operators will be affected by this AD. The procedures required by this AD action will require approximately 544 work hours per operator to accomplish, at an average labor cost of $55 per work hour. Based on these figures, the cost to the 15 affected U.S. operators to incorporate the revisions of the SID program is estimated to be $448,800.

The recurring inspection cost will require approximately 298 work hours per airplane per year to accomplish. The average labor charge will be $55 per work hour. Based on these figures, the recurring inspection total cost impact of the AD on U.S. operators is estimated to be $16,390 per airplane, or $3,638,580 for the affected U.S. fleet.

Based on the above figures, the total cost impact of this AD is estimated to be $4,087,380 for the first year, and $3,638,580 for each year thereafter. This total cost figure assumes that no operator has yet accomplished the requirements of this AD.

The regulations adopted herein will not have substantial direct effects on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government. Therefore, in accordance with Executive Order 12612, it is determined that this final rule does not have sufficient federalism implications to warrant the preparation of a Federalism Assessment.

For the reasons discussed above, I certify that this action (1) is not a "major rule" under Executive Order 12291; (2) is not a significant "rule" under DOT Regulatory Policies and Procedures (44 FR 11034, February 26, 1979); and (3) will not have a significant economic impact, positive or negative, on a substantial number of small entities under the criteria of the Regulatory Flexibility Act. A final evaluation has been prepared for this action and it is contained in the Rules Docket. A copy of it may be obtained from the Rules

Docket at the location provided under the caption "ADDRESSES."

List of Subjects in 14 CFR Part 39

Air transportation, Aircraft, Aviation safety, Incorporation by reference, Safety.

Adoption of the Amendment

Accordingly, pursuant to the authority delegated to me by the Administrator, the Federal Aviation Administration amends 14 CFR part 39 of the Federal Aviation Regulations as follows:

PART 39—AIRWORTHINESS DIRECTIVES

1. The authority citation for part 39 continues to read as follows:

Authority: 49 U.S.C. App. 1354(a), 1421 and 1423; 49 U.S.C. 106(g); and 14 CFR 11.89.

§ 39.13 [Amended]

2. Section 39.13 is amended by removing amendment 39–6330 (54 FR 25591, July 8, 1987), and by adding a new airworthiness directive (AD), amendment 39–8469, to read as follows:

93–01–15. McDonnell Douglas: Amendment 39–8469. Docket 91–NM–220–AD. Supersedes AD 87–14–06, Amendment 39–6330.

Applicability: Model DC–8 airplanes, certificated in any category.

Compliance: Required as indicated, unless accomplished previously.

To ensure the continuing structural integrity of these airplanes, accomplish the following:

(a) Within one year after August 10, 1987 (the effective date of AD 87–14–06, Amendment 39–5631), incorporate a revision into the FAA-approved maintenance inspection program which provides for inspection of the Principal Structural Elements (PSE's) defined in section 2 of volume I of McDonnell Douglas Report No. L26–011, "DC–8 Supplemental Inspection Document (SID)," dated December 1985, in accordance with section 2 of volume III of that document. The non-destructive inspection techniques set forth in Volume II of the SID provide acceptable methods for accomplishing the inspections required by this AD. All inspection results, negative or positive, must be reported to McDonnell Douglas, in accordance with the instructions of section 2 of volume III of the SID. Information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) under the provisions of the Paperwork Reduction Act of 1980 (44 U.S.C. 3501 *et seq.*) and have been assigned OMB Control Number 2120–0056.

(b) Within 6 months after the effective date of this AD replace the revision of the FAA-approved maintenance inspection program required by paragraph (a) of this AD with a revision that provides no less than the required inspection of the Principal Structural Elements (PSE's) defined in sections 2 and 3 of volume I of McDonnell Douglas Report No. L26–011, "DC–8 Supplemental Inspection Document (SID)," dated March 1991, in accordance with section 2 of volume III–91, dated April 1991, of that document. The non-destructive inspection techniques set forth in sections 2 and 3 of volume II, dated March 1991, of that SID provide acceptable methods for accomplishing the inspections required by this AD. All inspection results, negative or positive, must be reported to McDonnell Douglas, in accordance with the instructions of section 2 of volume III–91 of the SID. Information collection requirements contained in this regulation have been approved by the OMB under the provisions of the Paperwork Reduction Act of 1980 (44 U.S.C. 3501 *et seq.*) and have been assigned OMB Control Number 2120–0056.

(c) Cracked structure detected during the inspections required by paragraphs (a) and (b) of this AD must be repaired before further flight, in accordance with a method approved by the Manager, Los Angeles Aircraft Certification Office, FAA, Transport Airplane Directorate.

(d) An alternative method of compliance or adjustment of the compliance time that provides an acceptable level of safety may be used if approved by the Manager, Los Angeles Aircraft Certification Office (ACO), FAA, Transport Airplane Directorate. Operators shall submit their requests through an appropriate FAA Principal Maintenance Inspector, who may add comments and then send it to the Manager, Los Angeles ACO.

Note: Information concerning the existence of approved alternative methods of compliance with this AD, if any, may be obtained from the Los Angeles ACO.

(e) Special flight permits may be issued in accordance with FAR 21.197 and 21.199 to operate the airplane to a location where the requirements of this AD can be accomplished.

(f) Certain inspections and reporting shall be done in accordance with McDonnell Douglas Report No. L26–011, "DC–8 Supplemental Inspection Document (SID)," dated December 1985, as indicated. This incorporation by reference was approved previously by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR part 51 as of August 10, 1987 (54 FR 25591, July 8, 1987). Certain other inspections and reporting shall be done in accordance with McDonnell Douglas Report No. L26–011, "DC–8 Supplemental Inspection Document (SID)," volume I, revision 3, dated March 1991; volume II, revision 5, dated March 1991; and volume III–91, dated April 1991. Volume I (revision 3, dated March 1991) and volume II (revision 5, dated March 1991) of McDonnell Douglas Report No. L26–011, "DC–8 SID," contain the following list of effective pages:

Volume	Shown on "list of effective pages"	Revision level shown on page	Date shown on page
Volume I	List of effective pages A, B, C	3	March 1991.
Volume II	List of effective pages A, B, C, D, E, F, G, H, I, J, K, L	5	March 1991.

This incorporation by reference was approved by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR part 51. Copies may be obtained from McDonnell Douglas Corporation, P.O. Box 1771, Long Beach, California 90846–1771, attention: Business Unit Manager, Technical Publications—Technical Administrative Support, C1–L5B. Copies may be inspected at the FAA, Transport Airplane Directorate, 1601 Lind Avenue, SW., Renton, Washington; or at the FAA, Los Angeles Aircraft Certification Office, 3229 East Spring Street, Long Beach, California; or at the Office of the Federal Register, 800 North Capitol Street, NW., suite 700, Washington, DC.

(g) This amendment becomes effective on February 26, 1993.

Issued in Renton, Washington, on January 11, 1993.

N.B. Martenson,

Acting Manager, Transport Airplane Directorate, Aircraft Certification Service.

[FR Doc. 93–1432 Filed 1–21–93; 8:45 am]

BILLING CODE 4910–13–U

14 CFR Part 39

[Docket No. 92–CE–42–AD; Amendment 39–8474; 93–01–20]

Airworthiness Directives; Beech Model 300 Airplanes

AGENCY: Federal Aviation Administration, DOT.

ACTION: Final rule.

SUMMARY: This amendment supersedes Airworthiness Directive (AD) 89–22–12, which requires inspecting the upper aft cowling access door latches for proper

tension and total engagement of the adjusting bolts and striker plates on certain Beech Model 300 airplanes, adjusting or modifying the latches if tension or engagement requirements are not met, and modifying the cowling door to provide a more positive retention. A cowling door latch replacement kit has been developed that, if properly installed, provides a level of safety equivalent to the cowling door retention modification required by AD 89–22–12. This action retains the requirements of the previous AD and incorporates this new modification into the AD as a compliance option. The actions specified by this AD are intended to prevent separation of an aft cowling door, which could result in occupant injury if decompression or structural damage occurs.

DATES: Effective March 10, 1993.

The incorporation by reference of certain publications listed in the regulations is approved by the Director of the Federal Register as of March 10, 1993.

ADDRESSES: Service information that applies to this AD may be obtained from the Beech Aircraft Corporation, P.O. Box 85, Wichita, Kansas 67201–0085. This information may also be examined at the Federal Aviation Administration (FAA), Central Region, Office of the Assistant Chief Counsel, room 1558, 601 E. 12th Street, Kansas City, Missouri 64106; or at the Office of the Federal Register, 800 North Capitol Street, NW., suite 700, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Mr. James M. Peterson, Aerospace Engineer, Wichita Aircraft Certification Office, FAA, 1801 Airport Road, Mid-Continent Airport, Wichita, Kansas 67209; Telephone (316) 946–4145; Facsimile (316) 946–4407.

SUPPLEMENTARY INFORMATION: A proposal to amend part 39 of the Federal Aviation Regulations to include an AD that would apply to certain Beech Model 300 airplanes was published in the **Federal Register** on September 9, 1992 (57 FR 41114). The action proposed to supersede AD 89–22–12, Amendment 39–6351 (54 FR 41438, October 10, 1989), with a new AD that would (1) retain the inspection and modifications of the aft cowling doors that are required by AD 89–22–12; and (2) allow a cowling door latch replacement kit to be installed in lieu of the cowling door retention modification required by AD 89–22–12. The proposed actions would be accomplished in accordance with Beech SB No. 2394, issued August 1989, revised February 1991.

Interested persons have been afforded an opportunity to participate in the making of this amendment. No comments were received on the proposed rule or the FAA's determination of the cost to the public.

After careful review, the FAA has determined that air safety and the public interest require the adoption of the rule as proposed except for minor editorial corrections. The FAA has determined that these minor corrections will not change the meaning of the AD nor add any additional burden upon the public than was already proposed.

The FAA estimates that 152 airplanes in the U.S. registry will be affected by this AD, that it will take approximately 17 workhours per airplane to accomplish the required action if the operator chose to install the cowling door latch replacement kit (latch replacement option) or approximately 3 workhours per airplane to accomplish the required action if the operator accomplished the modification to provide a more positive cowling door retention (cowling door retention option), and that the average labor rate is approximately $55 an hour. Parts for the cowling door latch replacement kit cost approximately $2,372 per airplane. Based on these figures, the total cost impact of this AD on U.S. operators is estimated to be $505,664 (latch replacement option) or $25,080 (cowling door retention option).

AD 89–22–12, which will be superseded by this AD, requires that the cowling door retention option be accomplished on the affected airplanes. The only difference between that AD and this action is the choice of accomplishing either the latch replacement option or the cowling door retention option. Since the latch replacement option is not mandatory, the required action poses no additional cost impact upon U.S. operators of the affected airplanes than that which is already required by AD 89–22–12.

The regulations adopted herein will not have substantial direct effects on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government. Therefore, in accordance with Executive Order 12612, it is determined that this final rule does not have sufficient federalism implications to warrant the preparation of a Federalism Assessment.

For the reasons discussed above, I certify that this action (1) is not a "major rule" under Executive Order 12291; (2) is not a "significant rule" under DOT Regulatory Policies and Procedures (44 FR 11034, February 26, 1979); and (3) will not have a significant economic impact, positive or negative, on a substantial number of small entities under the criteria of the Regulatory Flexibility Act. A copy of the final evaluation prepared for this action is contained in the Rules Docket. A copy of it may be obtained by contacting the Rules Docket at the location provided under the caption ADDRESSES.

List of Subjects in 14 CFR Part 39

Air transportation, Aircraft, Aviation safety, Incorporation by reference, Safety.

Adoption of the Amendment

Accordingly, pursuant to the authority delegated to me by the Administrator, the Federal Aviation Administration amends 14 CFR part 39 of the Federal Aviation Regulations as follows:

PART 39—AIRWORTHINESS DIRECTIVES

1. The authority citation for part 39 continues to read as follows:

Authority: 49 U.S.C. App. 1354(a), 1421 and 1423; 49 U.S.C. 106(g); and 14 CFR 11.89.

§ 39.13 [Amended]

2. Section 39.13 is amended by removing AD 89–22–12, Amendment 39–6351 (54 FR 41438, October 10, 1989), and adding the following new AD:

93–01–20 Beech Aircraft Corporation: Amendment 39–8474; Docket No. 92–CE–42–AD. Supersedes AD 89–22–12, Amendment 39–6351.

Applicability: Model 300 airplanes (serial numbers FA–2 through FA–211 and FF–1 through FF–19), certificated in any category.

Compliance: Required as indicated, unless already accomplished (compliance with superseded AD 89–22–12).

To prevent separation of an aft cowling door, which could result in occupant injury if decompression or structural damage occurs, accomplish the following:

(a) Within the next 25 hours time-in-service (TIS) after the effective date of this AD, inspect the upper aft cowling access door latches for proper tension and total engagement of the adjusting bolts and striker plates in accordance with part I of the Accomplishment Instructions section of Beech Service Bulletin (SB) No. 2329, dated August 1989, revised February 1991.

(1) If improper tension is found, prior to further flight, adjust the cowling door latch in accordance with Beechcraft Super King Air 300 Maintenance Manual, chapter 71–10.

(2) If the adjusting bolts and striker plates do not totally engage, prior to further flight, modify the cowling door in accordance with Beechcraft Safety Communique No. 300–75.

(b) Within the next 50 hours TIS after the effective date of this AD, accomplish one of the following:

(1) Modify the cowlings to provide upper aft cowling access door retention in accordance with part II of the Accomplishment Instructions section of Beech SB No. 2329, dated August 1989, revised February 1991; or

(2) Install cowling door latch replacement Kit No. 101-9052-1 S in accordance with Part III of the Accomplishment Instructions section of Beech SB No. 2329, dated August 1989, revised February 1991.

(c) If the requirements of paragraphs (a), (a)(1), (a)(2), and (b)(1) were previously accomplished (compliance with superseded AD 89-22-12) in accordance with Beech SB No. 2329, dated August 1989, then no further action is required by this AD.

(d) Special flight permits may be issued in accordance with FAR 21.197 and 21.199 to operate the airplane to a location where the requirements of this AD can be accomplished.

(e) An alternative method of compliance or adjustment of the compliance time that provides an equivalent level of safety may be approved by the Manager, Wichita Aircraft Certification Office, FAA, 1801 Airport Road, room 100, Wichita, Kansas 67209. The request shall be forwarded through an appropriate FAA Maintenance Inspector, who may add comments and send it to the Manager, Wichita Aircraft Certification Office.

Note: Information concerning the existence of approved alternative methods of compliance with this AD, if any, may be obtained from the Wichita Aircraft Certification Office.

(f) The inspection and modification or installation required by this AD shall be done in accordance with Beech Service Bulletin No. 2329, dated August 1989, revised February 1991. This incorporation by reference was approved by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR part 51. Copies may be obtained from the Beech Aircraft Corporation, P.O. Box 85, Wichita, Kansas 67201-0085. Copies may be inspected at the FAA, Central Region, Office of the Assistant Chief Counsel, room 1558, 601 E. 12th Street, Kansas City, Missouri, or at the Office of the Federal Register, 800 North Capitol Street, NW., suite 700, Washington, DC.

(g) This amendment (39-8474) supersedes AD 89-22-12, Amendment 39-6351.

(h) This amendment (39-8474) becomes effective on March 10, 1993.

Issued in Kansas City, Missouri, on January 13, 1993.

Michael K. Dahl,

Acting Manager, Small Airplane Directorate, Aircraft Certification Service.

[FR Doc. 93-1437 Filed 1-21-93; 8:45 am]

BILLING CODE 4910-13-M

14 CFR Part 39

[Docket No. 90-CE-58-AD; Amendment 39-8431; AD 92-26-04]

Airworthiness Directives; Cessna 210 Series Airplanes

AGENCY: Federal Aviation Administration, DOT.

ACTION: Final rule; suspension of effectiveness.

SUMMARY: This document suspends the effectiveness for Airworthiness Directive (AD) 92-26-04, Amendment 39-8431, published in the **Federal Register** on Monday, December 7, 1992 (57 FR 57658). The Federal Aviation Administration (FAA) has received a petition for reconsideration of this action, and the FAA has concluded that the issues raised by the petition warrant further consideration.

EFFECTIVE DATE: Effective January 22, 1993, AD 92-26-04, Amendment 39-8431, is suspended.

FOR FURTHER INFORMATION CONTACT: Mr. Paul O. Pendleton, Aerospace Engineer, FAA, Wichita Aircraft Certification Office, 1801 Airport Road, room 100, Wichita, Kansas 67209; Telephone (316) 946-4143; Facsimile (316) 946-4407.

SUPPLEMENTARY INFORMATION: AD 92-26-04, Amendment 39-8431, which applies to certain Cessna 210 series airplanes, was published in the **Federal Register** on Monday, December 7, 1992 (57 FR 57658), with an effective date of January 22, 1993. This AD requires accomplishing operational checks of the fuel gauges, modifying the fuel caps and adapters, and incorporating pilot operating procedures that relate to preflight fuel system quantity checks into the airplane flight manual or airplane records.

The FAA has received a petition for reconsideration of this action, and believes that the issues raised by that petition warrant further consideration before compliance is mandated.

This rule would become effective on January 22, 1993. Since a situation exists that requires immediate public notice that the effective date has been suspended, it is found that notice and public procedure hereon are impracticable and good cause exists for making this amendment effective in less than 30 days.

Adoption of the Amendment

Accordingly, pursuant to the authority delegated to me by the Administrator, the Federal Aviation Administration amends 14 CFR part 39 of the Federal Aviation Regulations as follows:

PART 39—AIRWORTHINESS DIRECTIVES

1. The authority citation for part 39 continues to read as follows:

Authority: 49 U.S.C. App. 1354(a), 1421 and 1423; 49 U.S.C. 106(g); and 14 CFR 11.89.

§ 39.13 [Amended]

2. Section 39.13 is amended by suspending until further notice AD 92-26-04, Amendment 39-8431 (57 FR 57658, December 7, 1992), effective January 22, 1993.

Issued in Kansas City, Missouri, on January 15, 1993.

Michael K. Dahl,

Acting Manager, Small Airplane Directorate, Aircraft Certification Service.

[FR Doc. 93-1618 Filed 1-19-93; 11:20 am]

BILLING CODE 4910-13-M

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 34

Regulation of Hybrid Instruments

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rules.

SUMMARY: The Commodity Futures Trading Commission ("Commission" or "CFTC") is adopting final regulations concerning certain "hybrid" instruments that combine equity or debt securities or depository interests with features of either commodity futures or option contracts, or both. The final rules establish an exemption from CFTC regulations under the Commodity Exchange Act ("CEA" or "Act") 7 U.S.C. 1 et seq., for these hybrid instruments, based on the limited nature of the instrument's exposure to price movements in the underlying commodity and in reliance on other applicable regulatory frameworks.

EFFECTIVE DATE: February 22, 1993.

FOR FURTHER INFORMATION CONTACT: Gregory Kuserk, Industry Economist, or Barry Schachter, Financial Economist, Division of Economic Analysis, Commodity Futures Trading Commission, 2033 K St. NW., Washington, DC 20581. Telephone: (202) 254-6990.

I. Introduction

A. The Proposed Rulemaking

On November 12, 1992, the Commission published for comment proposed regulations to amend its part 34 rules which exempt from regulation under the CEA certain hybrid instruments.[1] The Commission proposed to expand part 34, which previously applied only to hybrid instruments that combine characteristics of commodity option contracts with securities or depository interests, to include hybrid instruments which have a futures-like component as well. As proposed, amended part 34 would establish a new test to determine the predominant character of a hybrid instrument. Those hybrid instruments in which the commodity interest did not predominate, as measured by the new test, would be exempt from regulation under the CEA. These proposals were based, in part, on the direction provided by Congress that the Commission may move promptly to exercise the exemptive authority granted to the Commission contained in section 4(c)(5)(A) of the recently enacted Futures Trading Practices Act of 1992.[2] The Commission proposed to determine the predominant character of a hybrid instrument, by decomposing it into its constituent components and then comparing a measure of the commodity price exposure associated with the commodity-dependent component of the hybrid instrument to the value of its commodity-independent component. Under the proposed test, hybrid instruments would have been exempt from Commission regulation if the measured commodity price exposure is less than the present value of the instrument's commodity-independent payments.[3]

Nothing in the revised test, as proposed or adopted herein, however, would change the underlying requirement that to qualify for this exemption an instrument must be a hybrid instrument; that is, it must combine the characteristics of an equity or debt security or a depository instrument with a futures-like or option-like component. Accordingly, instruments having returns indexed to, or calculated on, the basis of the price of a commodity that are not *bona fide* equity or debt securities or depository instruments will not be viewed as hybrid instruments even though they may incorporate some features common to securities or depository instruments.

B. Comments Received

The comment period ended on December 28, 1992, after having been extended for an additional period of 14 days. The Commission received 26 comment letters on the proposal: Two from futures exchanges (one of which was a joint letter from three futures exchanges), one from a stock exchange, three from law firms, two from banks, one from an individual, four from trade associations, five from investment banks, two from bank holding companies, two from professional associations and four from federal regulatory agencies.

Most commenters generally supported the overall objectives of the rulemaking. They noted that the proposed rule would provide greater legal certainty as to the regulatory framework applicable to specific hybrid instruments, reduce duplicative regulation and enhance financial innovation in U.S. capital markets. Most commenters also expressed the belief that exempting such instruments would be in the public interest. Accordingly, they urged the Commission to act expeditiously in adopting final rules.

However, these commenters also tempered their support with suggestions to modify or clarify certain aspects of the rule. Most requested that the proposed definition of an eligible security be simplified and enhanced to include a wider range of securities. Several also requested that the exempt status of any severable component-hybrids be determined at the time of issuance. In addition to the recommended modifications, other commenters suggested various clarifications, including the use of alternative, but commercially acceptable ways, to value the option components of the instrument when applying the test.[4]

A few commenters, however, strongly disagreed with the proposed rules. Several expressed the view that the technique used to establish predominance is flawed because the test uses a volatility-sensitive measure of exposure for futures-like components. Several also raised a concern that the proposed rule would deprive purchasers of hybrid instruments of protection under the commodity futures laws for that portion of a hybrid instrument that is commodity-dependent. One comment letter argued that the Commission's proposed test is flawed because it treats "the return of the performance bond deposit as if it were part of the return on the customer's investment."[5]

II. Statutory Determinations

As stated above, section 4(c) requires that the Commission make a number of determinations in granting exemptions. If an exemption is granted pursuant to section 4(c) from the requirements of section 4(a), the determinations are that the requirement of section 4(a) should not be applied to the agreement, contract or transaction and that the exemption is: (1) Consistent with the public interest; (2) consistent with the purposes of the Act and (3) the agreement, contract or transaction "will not have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory duties" under the Act.[6] The Commission has considered each of these criteria in making its determination that this exemption of certain hybrid instruments is consistent with the public interest.[7]

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[1] 57 FR 53618 (November 12, 1992). The Notice of Proposed Rulemaking contains a fuller description of the statutory basis for the proposed rule and of the history regarding the Commission's regulation of hybrid instruments. It also contains a fuller description, and explanation, of the economic calculations necessary under the rule.

[2] By exempting eligible hybrids from all of the provisions of the Act (other than section 2(a)(1)(B)), the Commission does not intend to suggest that the Commission's jurisdiction and authority under these provisions will be affected, including its authority to determine compliance with the terms of the exemption. See section 4(d) of the Act. As suggested by the Securities and Exchange Commission ("SEC"), the Commission also reiterates that in enacting these final rules, the Commission intends to provide legal certainty to novel instruments without necessarily making a determination that such instruments are subject to the Act. In certain cases the determination as to jurisdiction regarding such novel instruments is not straightforward and as noted in the Commission's proposed rulemaking, the Commission is not required to make such a finding in order to exercise this exemptive authority. See, 57 FR 53618 footnote 2 (November 12, 1992). Moreover, the Commission also notes that participants may continue to rely on its Statutory Interpretation Concerning Certain Hybrid Instruments for existing and new hybrid instruments. 55 FR 13582 (April 11, 1990).

However, the Commission's intention to exempt a direct investment that contains an equity or debt security or depository instrument in combination with a commodity-dependent component, does not apply to a trading vehicle, such as a pooled account, formed for the purpose of trading commodity instruments. Although commodity pools issue securities, such as limited partnership interests, the issuance of such securities, however, does not alter the basic nature of the commodity pool as a vehicle for trading commodity instruments.

[3] By the term "payment" the Commission meant any interest, coupon or dividend payment as well as any return of principal or liquidation preference.

[4] A comment submitted by a stock exchange raised the issue of the Commission's ability, under the authority of the Act, to exempt instruments referred to as "index participations." That action is not being considered by the Commission as part of this rulemaking.

[5] In this regard, the Commission notes that the commenter incorrectly characterized the commodity-independent component of a hybrid instrument as a "performance deposit." The hybrid exemption clearly extends only to certain securities and depository instruments as defined by federal law and regulation, and as such, payment to the issuer is not in the nature of a "performance deposit."

[6] Section 4(c)(2), 7 U.S.C. 6(c)(2). This section also conditions an exemption upon the transaction being entered into solely between appropriate persons.

[7] Persons engaged in activity otherwise subject to the Act would not be exempt for such activity, even

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Public Interest and Purposes of the Act Determination

As is frequently the case when Congress grants a regulatory agency authority to act consistent with "the public interest and the purposes of" its enabling statute, little statutory elaboration is given to the full scope of the phrase. As commonly understood, however, an agency, such as the Commission, is to apply this standard against the template of its regulatory scheme. In this regard, the Conference Report states that the "public interest" under section 4(c) includes "the national public interests noted in the (Act), the prevention of fraud and the preservation of the financial integrity of markets, as well as the promotion of responsible economic or financial innovation and fair competition." H.R. Rep. No. 978, 102d Cong., 2d Sess. 78. The Conference Report goes on to state that "(t)he Conferees intend for this reference to the 'purposes of the Act' to underscore their expectation that the Commission will assess the impact of a proposed exemption on the maintenance of the integrity and soundness of markets and market participants." H.R. Rep. No. 978, 102d Cong., 2d Sess. 78.

Hybrid instruments, in various forms, have been offered to the public under the Commission's Statutory Interpretation Concerning Certain Hybrid Instruments and part 34 of the Commission's regulations. The Commission's intent at the time was to provide regulatory certainty to hybrid instruments which are predominantly a debt, preferred equity or depository instrument but which also incorporate futures or commodity options in innovative formats.[8]

Hybrid instruments have widespread economic utility, offering a novel means of combining capital raising and risk shifting instruments in a single investment vehicle. Hybrid instruments can offer issuers means to raise capital through instruments that better fit the specific risk profile of the issuer. For example, the linking of debt repayment in a hybrid instrument issued by an oil company to the price of oil can allow the issuer to offer the possibility of a greater return in those instances when the issuer is better able to do so. This can allow issuers to obtain a lower cost of funds due to the willingness of the purchasers to pay a premium for the instruments. Purchasers of hybrid instruments may be willing to pay this premium to obtain instruments that fit specific risk management needs. Accordingly, the Commission is of the opinion that these innovative products offer economic utility and serve a *bona fide* capital raising function. In conclusion, the Commission believes that in consideration of the economic utility gained from these instruments, in combination with the protections afforded under the laws and regulations of other regulators, the exemption satisfies the statutory requirement that it be consistent with the public interest and the purposes of the Act.

Material Adverse Effect on Regulatory or Self-Regulatory Responsibilities

In making this determination, Congress indicated that the Commission is to consider such regulatory concerns as "market surveillance, financial integrity of participants, protection of customers and trade practice enforcement."[9]

In adopting these final rules, the Commission has been careful to ensure that any instruments exempted hereunder from CFTC regulation will be covered by alternative regulatory regimes.[10] Hybrid instruments would be subject to the same general regulations, including applicable anti-fraud laws, as apply to the comparable non-hybrid interests and no further limitation on who may purchase, sell, offer or enter into hybrid instruments was therefore deemed necessary.

Moreover, the record before the Commission provides no basis to support a conclusion that the purposes of or regulating efforts under the Act have been adversely affected by the markets in hybrids or will be so affected by the issuance of these rules. In particular, the Commission is unaware that the issuance of these instruments has been a source of fraud or abuse or in any way had a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory duties under the Act.

In addition, the structure and size of these offerings has been such that, to date, they do not represent a relevant pricing mechanism for the general price discovery process of the underlying commodity. Nevertheless, the Commission has determined in the final rule to preclude the ability of hybrid instruments to settle by means of a delivery instrument, such as an exchange-approved warehouse receipt or shipping certificate, that is specified in the rules of a designated contract market. This provision would prevent only settlement in delivery instruments specifically defined as such in exchange rules. It would not prevent settlement in the form of a commodity that is of deliverable grade or quality under exchange rules. The Commission believes that this requirement will not interfere with the ability of issuers to provide physical delivery alternatives to cash settlement but provides some protection against interference with deliverable supplies for settlement of designated futures or options contracts.[11] Thus, the Commission is amending the proposed rules to add § 34.3(a)(3)(iii) that will prohibit hybrid instruments from providing for settlement in the form of a delivery instrument such as an exchange-approved warehouse receipt or shipping certificate.

Finally, the Commission notes that under section 4(d) of the Act "the granting of an exemption under this section does not affect the authority of the Commission under any provision of this Act to conduct investigations in order to determine compliance with the requirements or conditions of such exemption or to take enforcement action for any violation of any provision of this Act or any rule, regulation or order thereunder caused by the failure to comply with or satisfy such conditions or requirements."

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if it were connected to their exempted hybrid activity. In this regard, the Commission wishes to make clear that the exemption does not apply to any financial, recordkeeping, reporting or other requirements imposed on any person in connection with their activities that remain subject to regulation under the Act. Thus, for example, futures commission merchants must continue to account for any liabilities arising out of any hybrid instruments in meeting the net capital requirements of Commission Rule 1.17 just as they do in the case of other financial instruments not regulated under the Act. Similarly, the risk assessment, recordkeeping and reporting requirements imposed on futures commission merchants by new section 4f(c) of the Act apply to the hybrid activities of their affiliated persons. As part of its ongoing review of its regulations, the Commission is considering revisions to Commission Rule 1.19. Suggestions by some commenters that Rule 1.19 should not be applicable to exempted hybrid instruments will be considered as part of this review.

[8] 54 FR 1128 (January 11, 1989) and 54 FR 1139 (January 11, 1989).

[9] H.R. Rep. No. 978, 102d Cong., 2d Sess. 79 (1992).

[10] If a hybrid instrument which is otherwise subject to the Act fails to meet the conditions of this exemption, the Act and Commission regulations would continue to apply.

[11] An important regulatory concern of the Commission is to reduce the likelihood of pricing anomalies on designated contract markets. Such protection against interference with those deliverable supplies represented by delivery instruments facilitates this function. The Commission also specifically wishes to make clear that those provisions of sections 6(c) and 9(a)(2) of the Act concerning manipulation or attempted manipulation of the market price of any commodity in interstate commerce or for future delivery on or subject to the rules of any contract market, would continue to apply to persons engaging in hybrid transactions.

Pursuant to its authority in new section 4(d) of the Act, the Commission intends routinely to consult with other regulators who have information concerning hybrid instruments, *e.g.*, the SEC and bank regulators, to seek to assure they include in their routine examination program these transactions. Under section 4(d) the Commission would exercise its authority to investigate, as appropriate.

Anticompetitive Considerations

Section 15 of the Act provides, in relevant part, that the Commission must consider the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the objectives, policies and purposes of the Act in adopting any rule, regulation or exemption under section 4(c).[12] Thus, a formal analysis under the antitrust laws is not, by itself, dispositive of the issues raised by a rule.[13] As a result, the Commission is not compelled by section 15 to take the least anticompetitive course of action. Rather, where alternatives with varying degrees of regulatory benefit exist, the Commission may adopt the approach that appears to be most likely to achieve the objectives, policies and purposes of the Act, even if that approach is not the least anticompetitive.[14]

Accordingly, section 15 requires the Commission to balance the likely anticompetitive impact of adopting a rule against the objective, policy or purpose of the Act which the rule may further. And, although the Commission must consider the public interest in maintaining or promoting competition, it need not weigh this interest equally against an objective, policy or purpose of the Act being served by a rule in reaching its final determination concerning the adoption of the rule.

The Commission's consideration of the proposed rule, and its evaluation of the comments received in this regard, for the following reasons, has led it to conclude that any possible anticompetitive effects are clearly outweighed by the rule's furtherance of the policies, purposes and objectives of the Act. In terms of fair competition, the Commission believes that the exemption of hybrid instruments from Commission regulation does not place regulated exchange-traded instruments at a competitive disadvantage to the commodity components of hybrid instruments. First, hybrid instruments, assessed as a whole, are not economic substitutes for exchange traded futures or options contracts. Exchange traded futures and option contracts serve mainly as risk shifting and price discovery vehicles. Although the commodity-component of a hybrid instrument can also function in this way, hybrid instruments more generally serve as capital raising devices.[15]

Secondly, although certain hybrid instruments would be exempt from Commission regulation, they will remain subject to the rules and regulations governing the issuance and trading of comparable instruments that do not have a commodity-dependent component. Thus, by enacting the exemption, new and innovative products that are predominantly not futures or options contracts can be developed under regulations common to other similar products in their class, without unnecessary, duplicative regulation, thereby fostering healthy competition in those markets.

In conclusion, the part 34 rules as set forth below and adopted herein are supported by appropriate determinations made in accordance with the standards set forth in section 4c of the Act for the granting of exemptions.

III. Substantive Revisions

Based upon its consideration of the comments received, and its own analysis, the Commission, as discussed in greater detail below, is adopting the amendments to part 34, as proposed, with the following modifications.

A. Section 34.2 Definitions

1. Section 34.2(a)—Hybrid Instrument

As proposed, under the definition of "hybrid instrument," the predominance test would be reapplied at the time of severance, for those instruments that could be severed, to determine the exempt status of the individual components. Several commenters suggested, however, that reapplying the proposed test at the time of severance would cast uncertainty on the legality of the severance of the instrument, thereby making such instruments unmarketable. Additionally, determining the exempt status at the time of severance, they argued, would shift to the investor the burden of applying the test.

These commenters suggested that to ameliorate this problem, the test be applied at the time of the instrument's issuance to all of the instruments that would result from its severance. Thus, at issuance, the issuer of an instrument that contained potentially severable components would first test the instrument as a whole to determine whether it was predominantly a security, and secondly, the potential individual instruments resulting from its severance. A hybrid instrument would be exempt from Commission regulation only where the instrument as a whole and each of the resulting potential severable hybrid instruments were deemed to be predominantly a security or depository interest.[16]

The Commission agrees with this suggested treatment of instruments with severable components and is deleting the phrase "and is determined at the time of issuance or severance" from the definition of hybrid instrument. The determination as to whether a hybrid instrument that provides for severability is predominantly an equity or debt security or depository interest, therefore, is to be determined at the time of issuance.[17]

2. Section 34.2(f)—Option premium

The definition of "option premium," proposed as § 34.2(d), stated that the value of the premium must be calculated using the same method as that used to determine the issue price of the instrument. Several commenters

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[12] Specifically section 15, as amended by section 502(b) of the 1992 Act, provides:

The Commission shall take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the objectives of this Act, as well as the policies and purposes of this Act, in issuing any order or adopting any Commission rule or regulation (including any exemption under sections 4(c) or 4c(b)), or in requiring or approving any bylaw, rule, or regulation of a contract market or registered futures association established pursuant to section 17 of this Act.

[13] *See Gordon v. New York Stock Exchange*, 422 U.S. 659, 690–691 (1975); *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963).

[14] *See, e.g., British American Commodity Options Corp. v. Bagley*, CCH Comm. Fut. L. Rep. ¶ 20,245 at 21,334 (S.D.N.Y. 1976), *aff'd in part and rev'd in part*, 552 F.2d 482 (2d Cir. 1977), *cert. denied*, 98 S.Ct. 427 (1977).

[15] In this regard, it should be noted that the purchaser of a hybrid securities instrument, in addition to obtaining an exposure to commodity prices, also obtains an exposure to the risk-return profile associated with the security of the firm that is bundled in the hybrid instrument.

[16] For example, if after a year, a hybrid instrument could be split into two hybrid instruments—*i.e.* each containing a commodity-independent and commodity-dependent component—the predominance test would be applied at the time of issuance to the instrument as a whole and to each of the two potentially severable hybrid instruments. If the instrument as a whole and each of the potentially severable components met the criteria of the rule, the instrument would be exempted from CFTC regulation.

[17] A comment by the Department of the Treasury asked the Commission to clarify in the rule the timing of the application of the predominance test. In addition, they contended that the statement in proposed § 34.2(a) that a hybrid instrument is "determined at the time of issuance or severance" appears to refer to the determination as to whether an instrument is a hybrid instrument, not to whether or not the hybrid instrument meets the predominance test. The above changes address these points.

noted that an option pricing model may not be used to determine the value of a commodity-dependent component, depending upon the component's nature. For example, it would be unnecessary to price the individual options that make up a synthetic futures position to determine its value. Instead, one could rely on the value of futures prices or some other pricing model which does not explicitly produce the value of the options.

The Commission is clarifying the definition of option premium, now in § 34.2(f), to make explicit that users may rely on commercially reasonable valuation methods to price options when the option prices have not been calculated directly in pricing the instrument. Commercially reasonable valuation methods would be those that conform to generally accepted economic principles and are appropriate to the nature of the instrument being priced. An appropriate model to price the individual options of a commodity-dependent component should result in a value that reflects the value of the commodity-dependent component used to price the hybrid instrument.[18] Similarly, in cases of an index, a spread or a basket of commodities, where an option premium is not directly calculated, issuers could rely on an appropriate option pricing model to price the options for purposes of applying the test. *See,* 57 FR 53622, n. 13.

B. Section 34.3 Hybrid Instrument Exemption

1. Section 34.3(a)(1)—Eligible Security and Deposit Interests

In proposed § 34.3(a)(1), the Commission specified a list of various debt, preferred equity or depository interests that were eligible for exemption under the criteria of part 34. Most comments received by the Commission, including those of the SEC, expressed a view that the list of securities in this section unnecessarily restricts the type of hybrid instruments that could qualify for an exemption. Moreover, the rules, by enumeration, may unnecessarily prevent new securities, not yet in existence, from obtaining exemption without further positive action by the Commission. Most commenters viewed as irrelevant the type of security or depository interest included in a hybrid instrument. In their view, it is important only that the security or depository interest be the dominant component and that the instrument be subject to another regulatory regime.

The Commission finds that these comments have merit. As a consequence, the Commission is amending its proposal to recognize as a hybrid, any instrument which combines a debt or equity security within the meaning of section 2(1) of the Securities Act of 1933 with futures or option-like features.

Similarly, a commenter expressed the view that, the method of offering the instrument is not germane to its predominant character or nature. Rather, it is only important that a hybrid instrument which is predominantly a security or depository instrument be issued in accordance with applicable securities and/or banking laws and regulations. The Commission concurs with this view. Thus, decisions regarding the issuance of hybrids that are predominately depository instruments are properly determined by the applicable banking regulator. Accordingly, the Commission is deleting from the final rule the proposed restriction that a depository instrument be sold through a broker registered in accordance with section 15 of the Securities Exchange Act of 1934.

2. Section 34.3(a)(2)—The Predominance Test

One comment letter argued that the proposed test is flawed because, when applied to a hybrid with an embedded futures contract, "adding the put and call premiums * * * (measures) * * * the volatility of the underlying commodity, just as if one were writing a commodity straddle." Rather than this evidencing a flaw, the Commission believes that, because price volatility is the fundamental source of risk in the commodity, it is desirable that the measure of the commodity price exposure be related to the volatility of the underlying commodity.

The commenter further argued that in designing a test, "volatility cannot be confused with 'commodityness' " and that "the return of principal loaned cannot be treated as part of the return on an investment." The Commission is unpersuaded by both of these assertions. First, as stated above, price volatility is the fundamental source of risk in the commodity, and any measure of commodity price exposure that is not sensitive to this fact can result in an inequitable treatment of potential instruments. Second, the existence of counterparty risk and the fact that there is an opportunity cost of funds loaned for a period of time require that the principal be part of the determination of the commodity-independent value.[19]

The Commission has determined, nevertheless, that the rule could be further clarified. Accordingly, the Commission is adding definitions for commodity-independent value and commodity-dependent value to § 34.2 of the final rules and is making the changes noted below to § 34.3(a)(2). Section 34.2(c), added to the final rules, defines "commodity-independent value" to mean the present value of the payments attributable to the commodity-independent component of a hybrid instrument, the payments of which do not result from indexing to, or calculation by reference to, the price of a commodity.[20] New § 34.2(e) defines "commodity-dependent value" to mean, for purposes of application of Rule 34.3(a)(2), the value of a commodity dependent-component, which when decomposed into an option payout or payouts, is measured by the absolute net value of the put option premia with strike prices less than or equal to the reference price, as defined in § 34.2(g), plus the absolute net value of the call option premia with strike prices greater than or equal to the reference price,

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[18] The phrase "value of the commodity-dependent component" used in this sense means the economic value of the commodity-dependent component, where, for example, in the case of a futures-like component, the long option premium is netted against the short option premium, as opposed to the sum of the absolute values of the long and short option premia. This differs from the definition in § 34.2(e) of the final rule which is intended to measure the commodity price exposure of the commodity-dependent component.

[19] The proposed test compares two values, the value of the commodity-independent component to the value of the commodity-dependent component. These values are, by necessity, measured differently, using those measures which are appropriate to ascertain the value of the particular component depending upon its nature. Accordingly, the exposure of the commodity-dependent component of the instrument is reflected by the value of individual option positions, and the value of the commodity-independent component is measured by its present value, a common means of valuation. Moreover, the proposed test achieves regulatory consistency because, under the test, instruments that produce an identical payout would qualify for exemption whether from a portfolio of hybrid instruments with simple commodity-dependent components or from a single instrument containing complex commodity-dependent components. In the simplest case the commodity-dependent component would be a single option combined with an equity or debt security or depository interest. The predominance test, as proposed, would then compare the value of that option to the value of the commodity-independent component. In order to treat a complex hybrid instrument in the same way as a portfolio of such simple hybrids that replicates the payout of the complex instrument, the relevant measure of the commodity-independent component of the complex instrument must be the value of the commodity-independent component. Such value is best reflected by the present value of all payments or considerations made by the issuer to the holder over the lifetime of the instrument.

[20] The term "commodity-dependent value," as defined in § 34.2(e), means the same as the term "commodity-price exposure" which was used in the proposed rule.

calculated as of the time of issuance of the hybrid instrument.

The remaining definitions are renumbered as a result of these additions. Finally, the predominance test of § 34.3(a)(2) is revised to conform to these revised definitions. It now states that for a hybrid instrument to be exempt, the sum of the commodity-dependent values of the commodity-dependent components must be less than the commodity-independent value of the commodity-independent component.[21]

3. Section 34.3(a)(3)—Maximum Loss Provisions of the Rules

Proposed § 34.3(a)(3) would have restricted the maximum loss to which a hybrid instrument holder could be subject. As proposed, the loss on any indexed coupon or interest payment could have been no greater than the commodity-independent coupon or interest payment and the loss on the indexed face value could not have exceeded the face value of the instrument. Several commenters indicated that this criterion could unnecessarily restrict an issuer's ability to allocate indexed returns between principal and interest in the design of the hybrid instrument.

The purpose of the maximum loss provision was not to place constraints on the structure of instruments that otherwise satisfy the criteria of part 34. Such restrictions on the overall structure are handled through the comparison of the commodity-dependent and commodity-independent components. Nevertheless, as stated in the Notice of Proposed Rulemaking, it is the Commission's view that instruments which allow commodity-dependent losses to accrue in excess of the face value of the instruments are more characteristic of a commodity interest than a debt, depository or equity interest. Accordingly, to restrict commodity-dependent losses while avoiding unnecessarily restricting the structure of hybrids deemed to be predominantly security or depository instruments, the Commission is revising § 34.3(a)(3). As revised, § 34.3(a)(3) provides that an issuer must receive full payment of the hybrid instrument's purchase price, and a purchaser or holder of a hybrid instrument may not be required to make additional out-of-pocket payments to the issuer during the life of the instrument or at maturity.[22]

4. Section 34.3(b)—Appropriate Persons

Under section 4(c)(2)(b)(i) of the Act, only transactions that are entered into between "appropriate persons" may be exempted from the requirements of section 4(a) of the Act. Proposed § 34.3(b) would have exempted instruments from regulation under the Act if, among other things, "the instrument is entered into solely between persons set forth in section 4(c)(3)(A)–(J) of the Act or otherwise permitted to enter into or purchase those instruments enumerated in paragraph (a)(1) of this section."

Many commenters requested the Commission to clarify that the exemption would be available to any participant who reasonably believes when entering into a hybrid instrument that the participant's counterparty qualifies as an "appropriate person." As revised, the final rule provides that, for purposes of this exemption, any person permitted by applicable securities or banking requirements to purchase or enter into the security or depository interest of the hybrid instrument would be an "appropriate person." Accordingly, to qualify for this exemption, the issuer or depository institution must have a reasonable basis to believe that its counterparty was permitted to purchase the instrument or to enter into the transaction under applicable federal or state securities or banking laws and regulations.[23]

IV. Other Comments

1. Instruments Beyond the Purview of the CEA and Commission Regulation

The Notice of Proposed Rulemaking noted that floating interest rate lending and depository instruments are not generally subject to the Act. See, 57 FR 53619 n. 8. Several commenters questioned whether this statement covers, in addition to depository or lending instruments, floating rate instruments that are securities. The Commission is clarifying that it did not intend to exclude floating interest rate securities from this list.

The Commission further stated that, regardless of the character of the formula or calculation used to determine the interest payment, floating rate instruments, the principal of which are returned upon maturity or redemption, are beyond the purview of the Act. The interest payment, however, in any period, must be determined solely by reference to interest rates (or indices thereof), or relationships between a constant and one or more interest rates (or indices thereof). See, 57 FR 53619 n. 8.

Several commenters asked whether this statement applies to instruments in which the principal is indexed to interest rates or indices thereof, and whether the term "formula" used in the statement includes multiples of interest rates, rate indices and spreads. In the view of the Commission, instruments in which the periodic payment is determined solely by reference to interest rates or indices, including multiples thereof, are beyond the purview of the Act. However, the Commission reiterates that instruments which are indexed to an interest rate in combination with indexation to a commodity, may fall under the purview of the Act. Of course, such an instrument nevertheless may be exempt from CFTC regulation under the terms of these part 34 rules.[24]

2. Reliance on Representations by Underwriters or Other Advisors

Several commenters noted that issuers typically rely on underwriters, selling agents or others to structure an offering in a manner which accomplishes the issuer's objectives and complies with applicable law. These commenters requested that the Commission clarify that an issuer should not be required to undertake its own analysis to assure compliance, but rather, that the issuer should be able to rely on the representation of the underwriter or other advisor as to compliance with these rules. In this regard, the

[21] As a point of clarification, the Commission notes that a hybrid instrument may contain multiple commodity components—*e.g.*, an instrument that contains both indexed coupons and principal. For such instruments, a value for each of the commodity-dependent components would be calculated and summed to obtain an overall value of the commodity-dependent portion of the instrument. This measure would then be used in the application of § 34.3(a)(2). The Commission further notes that a commodity-dependent component is not necessarily limited to indexing on a single commodity, but may be referenced to an index, a spread or a basket of commodities.

[22] The Commission intends that the issuer must receive full payment of the instrument's purchase price, excluding commissions and other selling costs. However, this restriction is not intended to prevent the purchaser or holder from acquiring the instrument on margin in accordance with applicable federal securities margin requirements.

[23] The above changes eliminate commenter's concerns whether such a hybrid is an eligible security in secondary market transactions.

[24] The Commission also noted in footnote 8 that instruments which simply involve spot translations from one currency into another would not be deemed to be commodity-dependent. Reference made to several interpretative letters—*i.e.*, CFTC Advisory No. 39–88, June 23, 1988 (Interpretative Letter No. 88–10, June 20, 1988, 2 Comm. Fut. L. Rep. (CCH) ¶ 24,262) (notes indexed to dollar/Yen exchange rate); CFTC Advisory No. 45–88, July 19, 1988 (Interpretative Letter No. 88–11, July 13, 1988, 2 Comm. Fut. L. Rep. (CCH) ¶ 24,284) (notes indexed to dollar/Yen exchange rate); and CFTC Advisory No. 48–88, July 26, 1988 (Interpretative Letter No. 88–12, July 22, 1988, 2 Comm. Fut. L. Rep. (CCH) ¶ 24,285) (notes indexed to dollar/foreign currency exchange rate)—was inadvertent.

Commission is of the opinion that although issuers may not necessarily themselves be required to perform all of the required calculations and analysis regarding whether an issue qualifies for exemption, and may rely on underwriters or other advisors for this analysis, they nevertheless must have a reasonable basis to believe that the instrument complies with these rules.

V. Other Matters

A. Paperwork Reduction Burden

The Paperwork Reduction Act of 1980 ("PRA"), 44 U.S.C. 3501, et seq., imposes certain requirements on Federal agencies (including the Commission) in connection with their conducting or sponsoring any collection of information as defined by the Paperwork Reduction Act. As the Commission noted in proposing these rules, it has determined that these rules do not impose any information collection requirements as defined by the PRA. No comments were received concerning the Commission's determination in this regard.

B. Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA"), 5 U.S.C. 601 et seq., requires that agencies, in promulgating rules, consider the impact of these rules on small entities. The Commission notes that the final rules are not intended to introduce any new prohibition but, rather, to provide exemptive relief from existing regulatory requirements. The adoption of these rules would enable current and potential issuers of hybrid instruments to expand the line of instruments now offered and allow issuers who issue instruments that contain option-like and futures-like components to rely on a single rule to determine regulatory jurisdiction. The Commission anticipates that the rule amendments will dispel uncertainty and establish consistent regulatory requirements for various types of commodity-related hybrid instruments, and thereby facilitate novel forms of financial transactions while fulfilling the mandates of the CEA. The Commission continues to believe that these rules do not have a significant economic impact on a substantial number of small entities. No comments were received concerning the RFA implications of the proposed rules.

List of Subjects in 17 CFR Part 34

Commodity futures, Commodity options, Hybrid instruments.

In consideration of the foregoing and pursuant to the authority contained in the Commodity Exchange Act and, in particular, sections 2, 4, 4c and 8a thereof, 7 U.S.C. 2, 6, 6c and 12a, the Commission hereby revises part 34 of title 17 of the Code of Federal Regulations as follows:

PART 34—REGULATION OF HYBRID INSTRUMENTS

Authority: 7 U.S.C. 2, 6, 6c and 12a.

§ 34.1 Scope.

The provisions of this part shall apply to any hybrid instrument which may be subject to the Act, and which has been entered into on or after October 23, 1974.

§ 34.2 Definitions.

(a) *Hybrid instruments.* Hybrid instrument means an equity or debt security or depository instrument as defined in § 34.3(a)(1) with one or more commodity-dependent components that have payment features similar to commodity futures or commodity option contracts or combinations thereof.

(b) *Commodity-independent component.* Commodity-independent component means the component of a hybrid instrument, the payments of which do not result from indexing to, or calculation by reference to, the price of a commodity.

(c) *Commodity-independent value.* Commodity-independent value means the present value of the payments attributable to the commodity-independent component calculated as of the time of issuance of the hybrid instrument.

(d) *Commodity-dependent component.* A commodity-dependent component means a component of a hybrid instrument, the payment of which results from indexing to, or calculation by reference to, the price of a commodity.

(e) *Commodity-dependent value.* For purposes of application of Rule 34.3(a)(2), a commodity-dependent value means the value of a commodity dependent-component, which when decomposed into an option payout or payouts, is measured by the absolute net value of the put option premia with strike prices less than or equal to the reference price plus the absolute net value of the call option premia with strike prices greater than or equal to the reference price, calculated as of the time of issuance of the hybrid instrument.

(f) *Option premium.* Option premium means the value of an option on the referenced commodity of the hybrid instrument, and calculated using the same method as that used to determine the issue price of the instrument, or where such premia are not explicitly calculated in determining the issue price of the instrument, the value of such options calculated using a commercially reasonable method appropriate to the instrument being priced.

(g) *Reference Price.* A reference price means a price nearest the current spot or forward price, whichever is used to price instrument, at which a commodity-dependent payment becomes non-zero, or, in the case where two potential reference prices exist, the price that results in the greatest commodity-dependent value.

§ 34.3 Hybrid instrument exemption.

(a) A hybrid instrument is exempt from all provisions of the Act and any person or class of persons offering, entering into, rendering advice or rendering other services with respect to such exempt hybrid instrument is exempt for such activity from all provisions of the Act (except in each case section 2(a)(1)(B)), provided the following terms and conditions are met:

(1) The instrument is:

(i) An equity or debt security within the meaning of section 2(1) of the Securities Act of 1933; or

(ii) A demand deposit, time deposit or transaction account within the meaning of 12 CFR 204.2 (b)(1), (c)(1) and (e), respectively, offered by an insured depository institution as defined in section 3 of the Federal Deposit Insurance Act; an insured credit union as defined in section 101 of the Federal Credit Union Act; or a Federal or State branch or agency of a foreign bank as defined in section 1 of the International Banking Act;

(2) The sum of the commodity-dependent values of the commodity-dependent components is less than the commodity-independent value of the commodity-independent component;

(3) Provided that:

(i) An issuer must receive full payment of the hybrid instrument's purchase price, and a purchaser or holder of a hybrid instrument may not be required to make additional out-of-pocket payments to the issuer during the life of the instrument or at maturity; and

(ii) The instrument is not marketed as a futures contract or a commodity option, or, except to the extent necessary to describe the functioning of the instrument or to comply with applicable disclosure requirements, as having the characteristics of a futures contract or a commodity option; and

(iii) The instrument does not provide for settlement in the form of a delivery instrument that is specified as such in the rules of a designed contract market;

(4) The instrument is initially issued or sold subject to applicable federal or state securities or banking laws to persons permitted thereunder to purchase or enter into the hybrid instrument.

Issued in Washington DC. on January 14, 1993, by the Commission.

Jean A. Webb,

Secretary of the Commission.

[FR Doc. 93–1366 Filed 1–21–93; 8:45 am]

BILLING CODE 6351-01-M

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17 CFR Part 35

Exemption for Certain Swap Agreements

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rule.

SUMMARY: On November 12, 1992, the Commodity Futures Trading Commission ("Commission") published for comment proposed new part 35 (the "Proposal") [1] which would exempt swap agreements (as defined herein) meeting specified criteria from regulation under the Commodity Exchange Act (the "Act"). This rule was proposed pursuant to authority recently granted the Commission, a purpose of which is to give the Commission a means of improving the legal certainty of the market for swap agreements. The original 30 day comment period was extended 14 days and closed December 28, 1992.[2]

The Commission has carefully considered the comments received and, based upon its review of the comments and its own reconsideration of the proposed rule, has determined to adopt part 35 in modified form, as discussed herein.

EFFECTIVE DATE: February 22, 1993.

FOR FURTHER INFORMATION CONTACT: Joanne T. Medero, General Counsel, Pat G. Nicolette, Deputy General Counsel, or David R. Merrill, Deputy General Counsel, Office of the General Counsel, Commodity Futures Trading Commission, 2033 K Street, NW., Washington, DC 20581. Telephone: (202) 254–9880.

SUPPLEMENTARY INFORMATION:

I. Statutory and Other Background

Section 2(a)(1)(A) of the Commodity Exchange Act ("CEA" or "Act") grants the Commission exclusive jurisdiction over "accounts, agreements (including any transactions which is of the character of * * * an 'option' * * *), and transactions involving contracts of sale of a commodity for future delivery traded or executed on a contract market * * * or any other board of trade, exchange, or market * * *." 7 U.S.C. 2. The CEA and Commission regulations require that transactions in commodity futures contracts and commodity option contracts, with narrowly defined exceptions, occur on or subject to the rules of contract markets designated by the Commission.[3]

On October 28, 1992, the Futures Trading Practices Act of 1992 ("1992 Act") was signed into law.[4] This legislation added new subsections (c) and (d) to section 4 of the Act. New section 4(c)(1) authorizes the Commission, by rule, regulation, or order, to exempt any agreement, contract or transaction, or class thereof, from the exchange-trading requirement of section 4(a) or any other requirement of the Act other than section 2(a)(1)(B).[5] New section 4(c)(2) provides that the Commission may not grant an exemption from the exchange-trading requirement of the Act unless, *inter alia*, the agreement, contract, or transaction will be entered into solely between appropriate persons listed in new section 4(c)(3), and the Commission determines that the agreement, contract, or transaction in question will not have a material adverse affect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory duties under the Act.[6]

Finally, new section 4(c)(5)(B) of the Act authorizes the Commission to exercise "promptly" the exemptive authority granted in section 4(c)(1) and to exempt swap agreements that are not part of a fungible class of agreements that are standardized as to their material economic terms to the extent that these instruments may be considered as subject to regulation under the Act.[7]

Pursuant to this new authority, the Commission on November 5, 1992 proposed rules to be set forth in a new part 35 that generally would exempt certain swap agreements from the Act. 57 FR 53627 (Nov. 12, 1992). The comment period, which had been extended by the Commission, expired on December 28, 1992.

The Commission has received in excess of 30 comment letters on the Proposal. The commenters included four futures exchanges; commercial banks, investment banks and other swap market participants; bank, securities industry, futures industry, and other trade associations; bar associations and law firms; government departments and agencies and members of the U.S. House of Representatives. Comments received after December 28 have been considered to the extent the Commission has been able to do so. All commenters, except the four futures exchanges and one commodity trade association, supported the Proposal but suggested modifications or clarifications to certain aspects of its provisions. These

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[1] 57 FR 53627.

[2] 57 FR 58423.

[3] Sections 4(a), 4c(b) and 4c(c) of the Act; 7 U.S.C. 6(a), 6c(b), 6c(c). Section 4(a) of the CEA specifically provides, *inter alia*, that it is unlawful to enter into a commodity futures contract that is not made "on or subject to the rules of a board of trade which has been designated by the Commission as a 'contract market' for such commodity." 7 U.S.C. 6(a). This prohibition does not apply to futures contracts made on or subject to the rules of a foreign board of trade, exchange or market. 7 U.S.C. 6(a).

[4] Pub. L. 102–546.

[5] Section 4(c)(1), 7 U.S.C. 6(c)(1), reads as follows:

In order to promote responsible economic or financial innovation and fair competition, the Commission by rule, regulation, or order, after notice and opportunity for hearing, may (on its own initiative or on application of any person, including any board of trade designated as a contract market for transactions for future delivery in any commodity under section 5 of this Act) exempt any agreement, contract, or transaction (or class thereof) that is otherwise subject to subsection (a) (including any person or class of persons offering, entering into, rendering advice or rendering other services with respect to, the agreement, contract, or transaction), either unconditionally or on stated terms or conditions or for stated periods and either retroactively or prospectively, or both, from any of the requirements of subsection (a), or from any other provision of this Act (except section 2(a)(1)(B)), if the Commission determines that the exemption would be consistent with the public interest.

[6] Section 4(c)(2), 7 U.S.C. 6(c)(2), reads as follows: The Commission shall not grant any exemption from any of the requirements of subsection (a) unless the Commission determines that—(A) The requirement should not be applied to the agreement, contract, or transaction for which the exemption is sought and that the exemption would be consistent with the public interest and the purposes of this Act; and (B) The agreement, contract, or transaction—(i) Will be entered into solely between appropriate persons; and (ii) Will not have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory duties under this Act. In this regard, the Conference Report on the 1992 Act states: The Conferees do not intend for this provision to allow an exchange or any other existing market to oppose the exemption of a new product solely on grounds that it may compete with or draw market share away from the existing market. H.R. Rep. No. 978, 102d Cong., 2d Sess. 79 (1992).

[7] Specifically, new section 4(c)(5)(B) states the Commission may: (B) Promptly following the enactment of this subsection, or upon application by any person, exercise the exemptive authority granted under paragraph (1) effective as of October 23, 1974, with respect to classes of swap agreements (as defined in section 101 of title 11, United States Code) that are not part of a fungible class of agreements that are standardized as to their material economic terms, to the extent that such agreements may be regarded as subject to the provisions of this Act.

commenters generally expressed the view that Part 35 would provide greater legal certainty to swap agreements, promote the development of certain financial safeguards in the swap market, and allow U.S. swap market participants to more effectively compete with foreign participants. Three of the four futures exchanges filed a joint comment letter (hereinafter the "Futures Exchanges Letter") which opposed the proposal on procedural and substantive grounds. Similar issues were raised in the other comment letter filed separately by a futures exchange.[8]

As discussed below, the Commission believes that part 35, as adopted, is responsive to the concerns of the commenters and has determined that it meets the criteria for the issuance of exemptive rules set forth in the Act.

II. Discussion

A. Scope of Rule

Several comment letters, including the Futures Exchanges Letter, have noted the Commission's efforts, both legislative and regulatory, to provide legal certainty for swap agreements. The Commission's review of the regulatory issues raised by swap agreements resulted in the issuance in July 1989 of a Statement of Policy ("Policy Statement") concerning certain swap transactions which recognized a non-exclusive safe harbor for transactions satisfying the statement's criteria.[9] Although the Policy Statement provided much needed clarity at that time concerning the regulatory treatment of swaps, Congress, in enacting the 1992 Act, encouraged the Commission to act promptly to issue an exemption to promote legal certainty in this area.[10] New part 35 is intended to promote domestic and international market stability, reduce market and liquidity risks in financial markets, including those markets (such as futures exchanges) linked to the swap market, and eliminate a potential source of systemic risk. To the extent that swap agreements may be regarded as subject to the provisions of the Act, the rules provide that those swap agreements which meet the terms and conditions set forth therein are exempt from all provisions of the Act, except section 2(a)(1)(B).[11] Although the Commission proposed to reserve certain non-regulatory sections of the Act from the exemption, the Commission agrees with those commenters that this reservation is unnecessary.[12] Nevertheless, in response to suggestions made in the Futures Exchanges Letter and the letter from the fourth commodity exchange, and to the extent that swap agreements may be deemed to be subject to the Act, the Commission has determined specifically to reserve in these rules the antifraud authority applicable to futures contracts and option transactions set forth in Sections 4b and 4o of the Act and Commission Rule 32.9, 17 CFR 32.9 (1992).

The rule is retroactive and effective as of October 23, 1974, the date of enactment of the Commodity Futures Trading Commission Act of 1974. The exemption would thus implement Congressional intent that the exemption from the Act be available for all eligible swap agreements, regardless of when (subsequent to October 23, 1974) the agreements may have been entered into. The issuance of this rule should not be construed as reflecting any determination that the swap agreements covered by the terms hereof are subject to the Act, as the Commission has not made and is not obligated to make any such determination.[13]

[8] The exchanges questioned the adequacy of the comment period for the rulemaking, noting that the Commission has employed a 60 day comment period in other instances. There is, of course, no legal impediment to the Commission's use of a 30 or 44 day comment period in this rulemaking, as the Administrative Procedure Act requires no fixed period for the submission of comments. *Phillips Petroleum Co.* v. *Environmental Protection Agency*, 803 F.2d 545 (10th Cir. 1986). The Commission notes, however, that its initial selection of 30 days was prompted by its desire to act "promptly" as Congress intended, and the fact that the swaps issue had already been subject to lengthy and careful consideration by both the Commission and the Congress over the past several years. See, e.g. Hearings on S. 207 before the Senate Committee on Agriculture, Nutrition, and Forestry, 102d Cong., 1st Sess. 452 (1991); Advanced Notice of Proposed Rulemaking, 52 FR 47022 (Dec. 11, 1987).

[9] 54 FR 30694 (July 21, 1989). The Commission has also recognized, as have others, that certain swap transactions may fall within the Act's jurisdictional exclusions for forward contracts, or the so-called Treasury Amendment or within the Commission's regulatory trade option exemption. *Id.* at 30695, fn. 12–15. To the extent that swaps transactions do not meet the exemptive criteria of part 35, but nevertheless fall within the trade option exemption, they will continue to be covered by that provision.

[10] In granting exemptive authority to the Commission under new section 4(c), the Conferees on the 1992 Act: recognize[d] the need to create legal certainty for a number of existing categories of instruments which trade today outside the forum of a designated contract market. These instruments may contain some features similar to those of regulated exchange-traded products but are sufficiently different in their purpose, function, design, or other characteristics that, as a matter of policy, traditional futures regulation and the limitation of trading to the floor of an exchange may be unnecessary to protect the public interest and may create an inappropriate burden on commerce. H.R. Rep. No. 978, 102d Cong., 2d Sess. 80 (1992). The Futures Exchanges Letter questions whether the Commission was "directed" by Congress to act promptly in issuing this exemption. A fair reading of section 4(c)(5) and the Conference Report indicates a clear expectation by Congress that the Commission would act promptly. H.R. Rep. No. 978, 102d Cong., 2d Sess. 81 (1992). If the word "promptly" is to be given effect, as it must under rules of statutory construction, its plain meaning argues for agency action sooner rather than later. Indeed the Commission was urged "to act and act swiftly." *Id.* There is no requirement for the Commission to wait until the completion of the study requested by Congress. In fact, Congress expected the Commission to exercise its exemptive authority before the study was completed. *Id.* at 83. In addition, once an agency is granted rulemaking authority it may proceed on a timetable established in its discretion, absent statutory language to the contrary.

[11] Numerous commenters asked that the Commission clarify its views regarding the section 2(a)(1)(B) limitation, part of the Shad/Johnson Jurisdictional Accord. As stated in the Proposal, by enactment of this part 35 the Commission does not intend to affect transactions undertaken in accordance with the Policy Statement. Further, in enacting this limitation, Congress "did not intend to call into question the legality of securities-based swap or other transactions which occur in the private marketplace at the present time, that do not violate the Accord." H.R. Rep. No. 978, 102d Cong., 2d Sess. 78 (1992). Swap market participants may continue to rely on the Policy Statement for existing and new swap agreements, including securities-based swaps.

[12] These proposed reservations encompassed sections 1a and 2(b), definitions; section 4(c) and 4(d), the exemptive authority provisions; section 8 dealing with, among other things, the Commission's treatment of confidential information; and, section 12(e)(2)(A), regarding the non-applicability of certain state laws to agreements exempted under section 4(c). By eliminating the reservations as applied to swap agreements, the Commission does not intend to suggest that these sections or any other section of the Act do not continue to apply to the Commission or to its authority and obligations under these sections or to any person or transaction not eligible for the exemption. See section 4(d) of the Act. Pursuant to its authority in new section 4(d) of the Act, the Commission intends routinely to consult with other regulators who have information concerning swap transactions, *e.g.*, the Securities and Exchange Commission pursuant to its risk assessment authority under the Market Reform Act of 1990, the Federal Reserve Board and other bank regulators to seek to assure they include in their routine examination program these transactions. Under section 4(d), the Commission would exercise its authority to investigate, as appropriate. The Commission also specifically wishes to make clear that those provisions of sections 69(c) and 9(a)(2) of the Act concerning manipulation or attempted manipulation of the market price of any commodity in interstate commerce or for future delivery on or subject to the rules of any contract market, would continue to apply to persons engaging in swap agreements but not to the swap agreements themselves. Part 35 does not affect the applicability or protections of state law (other than gaming or "bucket shop" laws), including applicable securities laws or antifraud statutes of general applicability, to these swap agreements or any other protections provided by other applicable federal laws. Congress specifically noted that, in exempting an instrument from the Act, the Commission cannot exempt it from applicable securities and banking laws and regulations. H.R. Rep. No. 978, 102d Cong., 2d Sess. 83 (1992).

[13] The contention expressed in the Futures Exchanges Letter that the Commission must make such a determination ignores the express language of 4(c)(5) and misstates Congressional intent as expressed in the Conference Report: The Conferees do not intend that the exercise of exemptive authority * * * would require any determination beforehand that the agreement * * * is subject to the Act * * *. Rather than making a finding as to

In enacting this exemptive rule, the Commission is also acting under its plenary authority under section 4c(b) of the Act with respect to swap agreements that may be regarded as commodity options.[14] The rule also exempts, as permitted by section 4(c)(1), all persons and entities for the activity of offering, entering into, rendering advice, or rendering other services with respect to swap agreements covered by the rule. Commenters indicated that the placement of this language in the rule was confusing. Accordingly, a clarifying modification has been made. Such persons, however, engaged in activity otherwise subject to the Act would not be exempt for such activity, even if it were connected to their exempted swaps activity. Also in this regard, the Commission wishes to make clear that the exemption does not apply to any financial, recordkeeping, reporting, or other requirements imposed on any person in connection with their activities that remain subject to regulation under the Act.[15] Thus, for example, futures commission merchants must continue to account for any liabilities arising out of any swap agreement in meeting the net capital requirements of Commission Rule 1.17 just as they do in the case of other financial instruments not regulated under the Act. Similarly, the risk assessment recordkeeping and reporting requirements imposed on futures commission merchants by new section 4f(c) of the Act apply to the swap agreement activities of their affiliated persons.

In adopting part 35, it is the intention of the Commission to exempt from regulation (to the full extent permissible by the Act) all swap agreements which satisfy the requirements of the rule and which may otherwise be subject to regulation under the Act.

B. Definition of Swap Agreement

Rule 35.1(b)(1) adopts the definition of "swap agreement" incorporated into new section 4(c)(5)(B) and specifically set forth in 11 U.S.C. 101(55). Although one commenter thought the definition was too restrictive and several encouraged broader application, the majority of those who commented on the use of this definition stated their support for its adoption. This definition reflects Congressional intent that the Commission endeavor to give legal certainty to swap agreements with differing economic and financial characteristics. In addition, as noted by one commenter, the use of the same definition that is used in the Bankruptcy Code will help to create greater certainty in the marketplace for swaps, given the extent to which market certainty has been enhanced by the exemption of "swap agreements" (as defined in the Bankruptcy Code) from the automatic stay and other provisions of the Bankruptcy Code. The definition reflects the diversity and evolving nature of swap transactions in the marketplace.[16] The Commission believes the terms and conditions of Rule 35.2 adequately limit the scope of activity permitted under the exemption.

C. Eligible Swap Participants

Most commenters suggested various modifications to the proposed definition of "appropriate person." The Commission has considered these comments and the final rule reflects the changes discussed below. In addition, in order to avoid confusion with the use in section 4(c)(3) of the Act of the phrase "appropriate person," the final rule substitutes the phrase "eligible swap participant." No substantive change is intended by this new phrase.

In the Proposal, the Commission generally used the list of "appropriate persons" set forth in new section 4(c)(3)(A) through (J) and utilized the authority granted by section 4(c)(3)(K) to determine other persons to be "appropriate persons" provided that a natural person would only qualify to the extent his or her net worth exceeds $5 million or total assets exceed $10 million. This approach is consistent with Congressional intent that the Commission may limit the terms of an exemption to some, but not all, of the listed categories of appropriate persons.[17]

In defining "eligible swap participant" in the final rule, the basic list is retained but is refined to clarify issues raised by the commenters. As the Act specifies that the swap agreement may only be "entered into" by appropriate persons, this determination is to be made at the inception of the transaction.[18] Further, it is sufficient that the parties have a reasonable basis to believe that the other party is an eligible swap participant at such time.[19]

Many commenters noted the international scope of the swaps market. While most of the categories of eligible swap participants are not limited to U.S. persons, subsections (iv), (v), (vii), (ix), and (x) of proposed Rule 35.1(b)(2) reference persons regulated under the United States law applicable to each. Thus, these references exclude regulated foreign persons performing similar roles in their home jurisdictions. Consistent with the policy reflected in section 4(c)(3)(K), the Commission believes that regulated foreign persons are "appropriate persons" and has modified these subsections of the final rule to include such persons as "eligible swap participants."[20]

The eligible swap participant must be acting on its own behalf or on behalf of another eligible swap participant as a counterparty in order to qualify under the Rule. A conforming change to Rule 35.1(b)(2)(i) has therefore been made. In most circumstances, the Commission will not "look through" eligible swap participants to their investors to apply the qualifications of Rule 35.1(b)(2) again. However, investment companies, commodity pools or entities which are collective investment vehicles formed solely for the specific purpose of constituting an eligible swap participant to enter into swap agreements will not be considered eligible swap participants

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whether a product is or is not a futures contract, the Commission in appropriate cases may proceed directly to issuing an exemption. H.R. Rep. No. 978, 102 Cong., 2d Sess. 82–83 (1992). The Futures Exchanges Letter advocates the view that to provide legal certainty to swap agreements the Commission need only exempt such agreements from the requirements of section 4(a) of the Act. The Commission does not read Congressional intent or its authority under section 4(c) so narrowly and has determined to exempt swap agreements which satisfy the requirements of the rule from regulation under the Act.

[14] See also footnote 12, *supra*.

[15] As part of its ongoing review of its regulations, the Commission is considering revisions to Commission Rule 1.19. Suggestions by some commenters that Rule 1.19 should not be applicable to exempted swap agreements will be considered as part of this review.

[16] The words "any similar agreement" in the definition includes any agreement with a similar structure to those transactions expressly included in the definition (e.g., a cap, collar, or floor) without regard to the nature of the underlying commodity interest involved.

[17] H.R. Rep. No. 978, 102d Cong., 2d Sess. 79 (1992).

[18] There is no requirement that a swap agreement be terminated if an eligible swap participant no longer qualifies as such. However, in order to permit the orderly winding-down of the positions of counterparties undergoing financial or other distress, an eligible swap participant may enter into a "closing transaction" with a counterparty even if the counterparty no longer qualifies as an eligible swap participant, provided however, that such closing transaction terminates all obligations between the counterparties to the swap. Under this circumstance, the Commission will consider such non-qualifying counterparty an "eligible swap participant" solely for the purpose of terminating any outstanding swap agreements.

[19] An eligible swap participant that has a reasonable basis to believe its counterparty is also an eligible swap participant when it enters into a master agreement may rely on such representation continuing, absent information to the contrary.

[20] The Commission considered comments that all non-United States persons be included in the definition of "eligible swap participant." However, as most categories of eligible swap participants are not limited to U.S. persons, this change accomplishes much the same result without favoring foreign participants over United States participants.

under the exemption. Conforming changes to Rule 35.1(b)(2) have been made to make this clear.

In the Proposal the Commission requested specific comment regarding the net worth and asset tests for "appropriate persons." A number of commenters indicated that the financial thresholds should be lower, particularly for individuals (for example, that the "accredited investor" threshold of Rule 501 under the Securities Act of 1933 be used), and that no financial thresholds should be imposed on individuals who are otherwise registered and regulated under the Act or the Securities Exchange Act of 1934 (such as broker-dealers, futures commission merchants, commodity trading advisors, and investment advisers).[21] Others noted the lower thresholds applicable to partnerships, corporations, or proprietorships under proposed Rule 35.1(b)(2)(vi). At least one commenter indicated that the proposed list of appropriate persons went beyond the existing market.

These financial thresholds are applied as an indication of financial sophistication and background. No commenters suggested that the proposed financial thresholds would adversely affect the market as conducted today, and on further consideration the Commission has determined to alter the financial tests for corporations and other entities, employee benefit plans and natural persons and to require commodity pools to have assets of at least $5,000,000.

In the final rule the Commission has increased the financial threshold tests for entities specified in Rule 35.1(b)(2)(vi) and natural persons to $10 million in total assets, and eliminated the net worth threshold. The Commission has added an alternative test for entities specified in Rule 35.1(b)(2)(vi) having net worth of at least $1 million and which enter into the swap agreement in connection with their businesses or to manage the risk of an asset or liability owned or incurred in the conduct of their businesses or reasonably likely to be owned or incurred in the conduct of their businesses.[22] Finally, the Commission has increased the asset test for employee benefit plans to $5,000,000.

D. Other Conditions

In addition to the condition that the swap agreement be entered into solely between eligible swap participants as specified in Rule 35.2(a), the final rule imposes three further conditions.[23]

First, as specified by section 4(c)(5) of the Act, Rule 35.2(b) provides that swap agreements may not be part of a fungible class of agreements that are standardized as to their material economic terms.[24] This condition is designed to assure that the exemption does not encompass the establishment of a market in swap agreements, the terms of which are fixed and are not subject to negotiation, that functions essentially in the same manner as an exchange but for the bilateral execution of transactions.[25] Standardization of material economic terms is a necessary, but not sufficient, condition for fungibility, as other factors, such as individual negotiation of other material terms or counterparty credit risk also affect fungibility.[26] As a result of, for example, the existence of common conventions in related markets or the hedging of risks incident to common assets or liabilities, a swap agreement may have the same economic terms but yet not be one of a fungible class of standardized agreements. For example, parties hedging the same or similar asset, such as a five year bond with semi-annual interest coupons, may individually negotiate the same economic terms to match cash flows, yet negotiate other terms and conditions, including the consideration of the creditworthiness of the counterparty.

Standardization of terms that are not material economic terms, for example, definitions, representations and warranties, and default and remedies provisions, as found in certain forms and master agreements published by various associations, is not by itself violative of this requirement.[27] Moreover, a swap agreement would not be considered fungible or standardized simply because it is subject to a netting system or arrangement permitted under paragraph (d) of the rule provided the material economic terms of the swap agreement are subject to individual negotiation by the parties.

Second, Rule 35.2(c) requires that the creditworthiness of any party having an actual or potential obligation under the swap agreement be a material consideration in entering into or determining the terms of the swap agreement including pricing, cost, or credit enhancement terms.[28] The

[21] The Futures Exchanges Letter suggested that the financial threshold for natural person floor traders and floor brokers be eliminated if such person's activities are guaranteed by a clearing member. Although the Commission has declined to make this change, it has added an alternative test for proprietorships as described above.

[22] To avoid uncertainty in the application of Rule 35.1(b)(2)(vi), the Commission is deleting reference to "business" before "entities" in this subsection. In addition, based upon comments received, the Commission has added credit unions to 35.1(b)(2)(ii) and made minor clarifying changes to subsections (vi) and (vii). Some commenters requested that the Commission specifically list entities, such as 501(c)(3) organizations under the Internal Revenue Code, in subsection (viii). The Commission believes such entities are contained within this subsection, and such specificity is unnecessary.

[23] The Futures Exchanges Letter proposes that the Commission add as a condition to the exemption that a self-regulatory organization ("SRO") be established to govern the swap market. Although couched in terms of the benefits of self-regulation, the objective underlying this proposal is revealed by the exchanges' statement that "(b)y the time the exchanges are ready to compete effectively * * * the dealers should have made and effectuated their SRO selection." Futures Exchanges Letter at 102. While it may be appropriate in some circumstances or for other reasons to condition an exemption on the existence or establishment of an SRO, the Commission declines to so condition this exemption and thus delay its implementation.

[24] The phrase "material economic terms" is intended to encompass terms that define the rights and obligations of the parties under the swap agreement and that, as a result, may affect the value of the swap at origination or thereafter. Examples of such terms may include notional amount, amortization, maturity, payment dates, fixed and floating rates or prices (including the methods by which such rates or prices may be determined), payment computation methodologies, and any rights to adjust any of the foregoing.

[25] The Futures Exchanges Letter questions the use of this condition and, in particular, one of the Commission's explanations of its purpose. Futures Exchanges Letter at 70–78. Distilled to its essence, the exchanges argue that the Commission's explanation is ambiguous because some swap agreements are as standardized as exchange traded futures, and that a swaps market which functions essentially as an exchange may exist today. The Commission does not find the purposes of this condition to be ambiguous as the exchanges assert. As to the assertion that some swap agreements are as standardized as exchange-traded futures contracts, this ignores the fact that most terms of exchange-traded futures contracts are set by the contract market, while all terms of swap agreements are subject to negotiation. As to the exchanges' other contention, a swaps market that today functions as an exchange would not be entitled to a part 35 exemption since the rule precludes exchange trading. See also Rule 35.2(d). Of course, what constitutes the "essential functions" of an "exchange" is subject to reasonable dispute but is generally left to an expert agency to decide. *Cf. Board of Trade versus Securities and Exchange Commission*, 883 F.2d 525 (7th Cir. 1989).

[26] One commenter suggested that legal certainty would be increased if the Commission deleted 35.2(b) and stated that a swap agreement which is assignable and transferable only with counterparty consent and/or the obligations thereunder are terminable, absent default, only with counterparty consent, is not part of a fungible class of agreements that are standardized as to their material economic terms. While the Commission agrees that transferability is one indicia of fungibility, other facts or circumstances may also determine whether or not a swap agreement meets the requirements of Rule 35.2(b).

[27] Standardization of these terms in published forms is not dissimilar to the standardization of terms for other areas, such as letters of credit. The publication of such standard terms facilitates communications and negotiations, but does not mean the provisions themselves are not subject to substantial negotiation.

[28] The Futures Exchanges Letter asserted that the Commission's choice of certain conditions in the Proposal was an impermissible attempt to employ the criteria from the Senate version of the 1992 Act

standard is intended to be objective, and does not require parties to actually negotiate (or demonstrate that they have negotiated) particular provisions. The clarifying phrase in the rule regarding "any party having an actual or potential future obligation" refers to obligations that create credit risk, not to ancillary obligations, such as obligations to deliver documents or perform (or refrain from performing) financial or business-related covenants. By this criterion, at this time, the exemption does not extend to transactions that are subject to a clearing system where the credit risk of individual members of the system to each other in a transaction to which each is a counterparty is effectively eliminated and replaced by a system of mutualized risk of loss that binds members generally whether or not they are counterparties to the original transaction.[29]

Based upon comments from futures exchanges and others, the Commission has revised the proviso to Rule 35.2(b) and (d) to clarify its meaning and to distinguish bilateral arrangements or facilities from multiparty arrangements or facilities. Under the proviso, bilateral arrangements for the netting of obligations to make payments or transfers of property, including margin or collateral, would be permitted. Multiparty netting arrangements would also be permitted, provided that the underlying gross obligations among the parties are not extinguished until all netted obligations are fully performed.

In addition, the "creditworthiness" condition is not intended to limit the ability of parties to undertake any bilateral collateral or margining arrangements to address credit issues. By expanding the ability of swap participants to utilize collateral and margin arrangements beyond that which is explicitly permitted under the Policy Statement, these rules should promote arrangements that will reduce risk within the financial system.[30]

Third, Rule 35.2(d) provides that the swap agreement may not be entered into and traded on or through a multilateral transaction execution facility. In this context, a multilateral transaction execution facility is a physical or electronic facility in which all market makers and other participants that are members simultaneously have the ability to execute transactions and bind both parties by accepting offers which are made by one member and open to all members of the facility. This limitation is not intended to preclude participants from engaging in privately negotiated bilateral transactions, even where these participants use computer or other electronic facilities, such as "broker screens," to communicate simultaneously with other participants so long as they do not use such systems to enter orders to execute transactions.[31] The Commission understands such facilities are in use today.

The Commission believes that transaction execution facilities could provide important benefits in terms of increased liquidity and price transparency. However, as is the case with clearing facilities, transaction execution facilities for swap agreements are not yet in existence, and present different regulatory issues than are raised by the exemption provided by the final rule. Thus, transaction execution facilities are beyond the scope of part 35 as adopted today. Consistent with the proviso in the final rule, however, the Commission invites applications for appropriate exemptive relief for such facilities as they are developed.

E. Statutory Determinations

As stated above, section 4(c) requires that the Commission make a number of determinations in granting exemptions.[32] If an exemption is granted pursuant to section 4(c) from the requirements of section 4(a), the determinations are that the requirement of section 4(a) should not be applied to the agreement, contract, or transaction and that the exemption is (1) consistent with the public interest; (2) consistent with the purposes of the Act; and (3) the agreement, contract, or transaction "will not have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory duties" under the Act.[33] With regard to the exchange trading requirement of section 4(a), the swaps market presently exists outside the forum of exchange trading

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which had mandated a swap exemption. However, as enacted, section 4(c)(1) expressly empowers the Commission to grant exemptions on "stated terms or conditions." As the Conferees recognized, the Commission may impose conditions on the swaps exemption "beyond those of lack of fungibility and standardization." H. Rep. 978, 102 Cong., 2d Sess. at 82 (1992).

[29] As recognized by the Futures Exchanges Letter, such a mutualized system would constitute a clearing system not unlike those employed by the exchanges. See also footnote 30, *infra*.

[30] The Commission shares the goal of financial system risk reduction as expressed in the comment letters from the Department of the Treasury, the Board of Governors of the Federal Reserve System ("Board"), and Office of the Comptroller of the Currency ("OCC"). The Commission understands these comment letters to generally support the promulgation of part 35 but to express concern that Commission rules should go further to promote the reduction of systemic risk. In this regard, while the OCC and the Board endorsed the development of appropriately structured multilateral payment netting for swaps, the Board also observed that the Commission should permit multilateral settlement (or clearing) so risk of loss could be mutualized. The Commission believes that a clearing house system for swap agreements could be beneficial to participants and the public generally. However, as such mechanisms are not yet in existence, and may take many forms and raise different regulatory concerns depending upon their structure or participants or whether another regulatory regime is applicable, the Commission will consider the terms and conditions of such an exemption for swap clearing houses in the context of specific proposals from exchanges, other regulators, or others. The Commission has added a proviso to the final rule to make clear that in this regard any party may apply for exemptions from the Act and that the Commission will consider the terms and conditions that may be appropriate, including other applicable regulatory regimes. While not limiting exemptions to those conditioned upon another regulatory scheme (and not otherwise limiting the imposition of conditions) the Commission is mindful of the costs of duplicative regulation. The Commission intends to give market participants maximum latitude in developing multilateral mechanisms to control credit and settlement risk which may reduce systemic risk. The new proviso reflects the Commission's determination to encourage innovation in developing the most efficient and effective types of systemic risk reduction. The Commission has previously recognized the virtues of clearing systems that mutualize risk and do not believe that this Rule should disadvantage the development of such systems. The Commission believes that the design of swap clearing facilities and the services that the facility will offer should be driven by the needs and desires of swap market participants.

[31] The Futures Exchanges Letter appears to confuse electronic and computer facilities which provide information to those having access to the facility, with physical or electronic facilities which allow participants to execute and trade instruments or contracts. A computer-based trading system for swap agreements is beyond the scope of these rules but may be the proper subject of the Commission's further exercise of its authority under section 4(c). See also footnote 30, *supra*.

[32] Contrary to the contention of the Futures Exchanges Letter, the plain meaning of the statute requires only that the determinations be made when the exemption is granted, but not when an exemption is merely proposed. *See* section 4(c)(2). The four exchanges also contend that the Proposal violates the Administrative Procedure Act ("APA") by failing to provide, among other things, an opportunity for "meaningful comment." The APA requires that a notice of proposed rulemaking include "either the terms or substance of the proposed rule or a description of the subjects and issues involved." 5 U.S.C. 553(b). In this instance the Proposal met both tests: it not only provided a description of the subject issues involved, it set forth the full text of the proposed rule. Further, this APA provision has been interpreted by one court to mean that the notice should be of sufficient detail and rationale to permit parties to comment meaningfully. *See, Fertilizer Inst. v. EPA*, 935 F.2d 1302, 1310–11 (D.C. Cir. 1991). The numerous detailed comment letters received support the conclusion that an opportunity for meaningful comment was provided by the Proposal. Further, despite their protestations to the contrary, the four futures exchanges who filed in opposition (and, in particular, the 108-page Futures Exchanges Letter) appeared to be sufficiently informed of the Commission's rationale to comment "meaningfully" on the Proposal.

[33] Section 4(c)(2), 7 U.S.C. 6(c)(2). This section also places a condition on an exemption from section 4(a) of the Act that the transaction will be entered into solely between appropriate persons. As discussed above, the Commission has made this a prerequisite for the swap agreement to qualify for exemption under Part 35.

and the Commission has determined that the requirement should not be applied to swap agreements meeting the conditions of the exemption. Indeed, one of the prerequisites for the exemption is that the swaps agreement not be standardized like exchange products or entered into or traded on a multilateral execution transaction facility.[34]

Public Interest and Purposes of the Act Determination

As is frequently the case when Congress grants a regulatory agency authority to act consistent with "the public interest and the purposes of" its enabling statute, little statutory elaboration is given to the full scope of the phrase. As commonly understood, however, an agency, such as the Commission, is to apply this standard against the template of its regulatory scheme. In this regard, the Conference Report states that the "public interest" under section 4(c) includes "the national public interests noted in the (Act), the prevention of fraud and the preservation of the financial integrity of markets, as well as the promotion of responsible economic or financial innovation and fair competition." H.R. Rep. No. 978, 102d Cong., 2d Sess. 78 (1992).[35] The Conference Report goes on to state that "(t)he Conferees intend for this reference to the 'purposes of the Act' to underscore their expectation that the Commission will assess the impact of a proposed exemption on the maintenance of the integrity and soundness of markets and market participants." *Id.*

Swap agreements are used by corporations, financial institutions, governments, governmental entities, and others, and are important tools that are used by these entities to hedge or manage financial risk and accomplish other financial objectives. In issuing this exemption, the legal risk (that the agreements would be unenforceable), and thus financial risk, is reduced within the financial markets and that legal certainty contributes to the preservation of the financial integrity of the markets.[36] By removing or reducing uncertainty, the final rule should promote innovation in the swaps market by allowing participants to negotiate and structure transactions that most effectively address their economic needs.[37]

Further, the exemption will assist United States financial institutions to compete with foreign rivals in the highly competitive market for swaps by removing a regulatory uncertainty with respect to the market in the United States that has not been present in most other major financial and industrial countries. In this regard, the exchanges' comment that "fair competition" under section 4(c) means that the rule as finalized must permit the exchanges to conduct a swaps market in their own manner is without merit. Exchanges and their members are not excluded from these rules, however, and may participate in swap agreements on the same terms and conditions that apply to all other eligible swaps participants.[38]

Material Adverse Effect on Regulatory or Self-Regulatory Responsibilities

In making this determination, Congress indicated that the Commission is to consider such regulatory concerns as "market surveillance, financial integrity of participants, protection of customers and trade practice enforcement." [39]

The record before the Commission does not support a conclusion that the purposes of the Act or the Commission's regulatory efforts thereunder have been adversely affected by the swaps market or will be so affected by the issuance of this exemption. Swap transactions have been entered into by a variety of participants for more than a decade, and the number of defaults appears to be low.[40] Nor do allegations of fraud appear to be an issue in this market. The Commission has addressed concerns regarding financial integrity and customer protection through the requirement that swaps only be entered into between eligible swap participants and that, as provided in Rule 35.2(b), creditworthiness of the parties be a material consideration. This approach precludes anonymous transactions and ensures that swap agreements will be limited to those persons who are sophisticated or financially able to bear risks associated with the transactions.[41]

The Commission also notes that the existence of the swap market, which by any measurement (*e.g.*, total notional amount at year end 1991 of $4 trillion) has not to date affected the ability of the futures exchanges to fulfill their self-regulatory duties.[42] It is widely acknowledged that the futures market and the swap market are linked, with swap market participants using certain exchange traded futures as hedging vehicles.[43] By creating a more certain legal environment for swaps, the potential for systemic risk is reduced, and there is no reason to conclude that the exchanges' self-regulatory responsibilities will be adversely affected by permitting the swaps market to continue on this basis.[44]

Anticompetitive Considerations

Section 15 of the Act provides, in relevant part, that the Commission must consider the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the objectives, policies, and purposes of the Act in adopting any rule, regulation, or exemption under section 4(c).[45] Thus, a

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[34] See discussion above regarding Rule 35.2(c) and (d). See also H. Rep. No. 102–978, 102d Cong., 2d Sess. 80 (1992).

[35] The Futures Exchanges Letter notes that in addressing certain elements of the public interest for futures trading, Congress has indicated that contract market designation and regulation under the Act is necessary to avoid creating an undue burden on commerce. *See* section 3 of the Act. Seventy years after the enactment of section 3, however, Congress enacted section 4(c) authorizing exemptions from section 4(a) of the Act because "traditional futures regulation * * * may create an inappropriate burden on commerce." H.R. Rep. No. 978, 102d Cong., 2d Sess. 80 (1992).

[36] The Futures Exchanges Letter appears to say in several places that the Commission must find that the exemption provides legal certainty. While this is certainly a goal of the final rule, it is not a statutorily mandated finding which the Commission must make.

[37] As noted in several comment letters, including comments from federal regulators, permitting mark-to-market margin and collateral and multiparty payment netting systems reduces financial risk and encourages responsible economic innovation.

[38] In considering fair competition, Congress expected that "the Commission will apply consistent standards based on the underlying facts and circumstances of the transaction and markets being considered and may make distinctions between exchanges and other markets, taking into account the particular facts and circumstances involved * * * where such distinctions are not arbitrary and capricious." H.R. Rep. No. 978, 102d Cong., 2d Sess. 78 (1992).

[39] H.R. Rep. No. 978, 102d Cong., 2d Sess. 79 (1992).

[40] Azarchs, "Banks Face Manageable Risks in Derivative Businesses," Standard & Poors Credit Week, November 1992.

[41] In enacting the 1992 Act, Congress explicitly authorized exemptions from all provisions of the Act (except 2(a)(1)(B)) and simultaneously enacted a "conforming amendment" to 12(e)(2) explicitly acknowledging that state antifraud statutes of general applicability would continue to apply to exempted transactions. See also footnote 12, *supra*.

[42] Indeed, in their lengthy submissions, the futures exchanges do not claim that approval of the Proposal will adversely affect their self-regulatory responsibilities.

[43] See, *e.g.*, Thompson, "Oil Swaps, A Potential Source of New Business for NYMEX," Futures Industry, November–December 1992.

[44] The Commission is unaware of any swap agreements that provide for settlement by tendering a delivery instrument, such as an exchange-approved warehouse receipt or shipping certificate, that is specified in the rules of a designated contract market. Swap agreements of this kind could have an effect upon deliverable supplies for settlement of designated futures or option contracts and, accordingly, the creation of such agreements should occur only after consultation with the Commission.

[45] Specifically section 15, as amended by section 502(b) of the 1992 Act, provides: The Commission shall take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving

formal analysis under the antitrust laws is not, by itself, dispositive of the issues raised by a rule.[46] As a result, the Commission is not compelled by section 15 to take the least anticompetitive course of action. Rather, where alternatives with varying degrees of regulatory benefit exist, the Commission may adopt the approach that appears to be most likely to achieve the objectives, policies, and purposes of the Act, even if that approach is not the least anticompetitive.[47]

Accordingly, section 15 requires the Commission to balance the likely anticompetitive impact of adopting a rule against the objective, policy, or purpose of the Act which the rule may further. And, although the Commission must consider the public interest in maintaining or promoting competition, it need not weigh this interest equally against an objective, policy, or purpose of the Act being served by a rule in reaching its final determination concerning the adoption of the rule.

The Commission's consideration of the proposed rule and its evaluation of the comments received in this regard has led it to conclude that any possible anticompetitive effects are clearly outweighed by the rule's furtherance of the policies, purposes, and objectives of the Act for the following reasons.

First, the proposal does not appear to raise any significant competitive issues. As several commenters noted, the exemption, by improving the legal certainty of the market for swap agreements, will increase growth, innovation, and competition in this market. Competition, in particular, will be promoted because of the flexibility provided by the exemption concerning persons who may appropriately enter swap transactions. In this regard, in addition to those now participating in swap transactions under the Commission's Policy Statement, the exemption would allow other persons, including futures exchanges or affiliates thereof, to engage in swap transactions on the same basis as all other participants.[48]

Second, the exemption furthers a fundamental objective of the Act, i.e., implementing new section 4(c)(5)(B) of the Act, which authorizes the Commission to exercise "promptly" its exemptive authority concerning swap agreements of the kind described therein. In this regard, the Conference Report on the 1992 Act notes that "the Conferees expect and strongly encourage the Commission to use its new exemptive powers promptly upon enactment in * * * areas where significant concerns of legal uncertainty have arisen (including) * * * swap * * *."[49] The Commission believes that the exemption adopted herein is responsive to these Congressional concerns and is properly circumscribed in accordance with the criteria set forth in the 1992 Act.

Finally, the Commission is unaware of any anticompetitive practices or other discernible adverse effects arising during the evolution and development of the swaps market, particularly as the market has developed in reliance on its Swaps Policy Statement. It is therefore reasonable to expect that the exemption will be similarly devoid of adverse effects on competition.

In conclusion, the part 35 rules as set forth below and adopted herein are supported by appropriate determinations made in accordance with the standards set forth in section 4(c) of the Act for the granting of exemptions.

F. Future Exemptive Relief

The Commission will, consistent with section 4(c), consider further exemptive relief on its own initiative or upon application by any person (including futures exchanges) for agreements, transactions, or contracts (including classes thereof) not addressed in this rule. To the extent that market participants wish to use or establish a multilateral transaction execution facility for swap transactions, or clearing systems involving mutualized risk or multiparty netting of payment obligations, the Commission will evaluate the terms and conditions, if any, that would be appropriate under section 4(c) of the Act in connection with any request for exemptive relief involving such a facility.

II. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA"), Public Law No. 96–354, 94 Stat. 1164 (1980), 5 U.S.C. 601 *et seq.*, requires each federal agency to consider, in the course of proposing substantive rules, the effect of those rules on small entities. A small entity is defined to include, *inter alia*, a "small business" and a "small organization." 5 U.S.C. 601(6).[50] The Commission previously has formulated its own standards of what constitutes a small business with respect to the types of entities regulated by it. The Commission has determined that contract markets,[51] futures commission merchants,[52] registered commodity pool operators,[53] and large traders[54] should not be considered small entities for purposes of the RFA.

The Commission continues to believe that it is unlikely that firms defined as small businesses under section 3 of the Small Business Act could offer or be offered swap agreements and thus be affected by the proposed rule exempting such agreements. Further, the proposed rule would not add any legal, accounting, consulting, or expert costs but rather would broaden the categories of permissible products sold other than on designated exchanges. The determination of whether a swap agreement would qualify for the proposed exemption requires minimal analysis of data that will be readily accessible to the offeror.

No comments were received with respect to the RFA implications of new part 35.

B. Paperwork Reduction Act

The Paperwork Reduction Act of 1989 ("PRA"), 44 U.S.C. 3501 *et seq.*, imposes certain requirements on federal agencies (including the Commission) in connection with their conducting or sponsoring any collection of information as defined by the PRA. As the Commission noted in proposing part 35, it has determined that proposed part 35 does not impose any information

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the objectives of this Act, as well as the policies and purposes of this Act, in issuing any order or adopting any Commission rule or regulation (including any exemption under sections 4(c) or 4c(b)), or in requiring or approving any bylaw, rule, or regulation of a contract market or registered futures association established pursuant to section 17 of this Act.

[46] See *Gordon* v. *New York Stock Exchange*, 422 U.S. 659, 690–691 (1975); *Silver* v. *New York Stock Exchange*, 373 U.S. 341 (1963).

[47] See, *e.g.*, *British American Commodity Options Corp.* v. *Bagley*, Comm. Fut. L. Rep. (CCH) ¶20,245 at 21,334 (S.D.N.Y. 1976), *aff'd in part and rev'd in part*, 552 F.2d 482 (2d Cir. 1977), *cert. denied*, 98 S.Ct. 427 (1977).

[48] The Futures Exchanges Letter argues that the exemption, because it does not permit exchange trading of the swap agreements being exempted, promotes unfair competition. As is noted above, however, the exchanges (or their affiliates) remain free to compete under the final rules on an equal footing with all other eligible swap participants.

[49] H.R. Rep. No. 978, 102d Cong., 2d Sess. 81 (1992).

[50] "Small organizations," as used in the RFA, means "any not-for-profit enterprise which is independently owned and operated and is not dominant in its field * * *" 5 U.S.C. 601(4). The RFA does not incorporate the size standards of the Small Business Administration ("SBA") for small organizations. Agencies are expressly authorized to establish their own definition of small organization. *Id.*

[51] 47 FR 18618 (April 30, 1982).

[52] *Id.* at 18619.

[53] *Id.*

[54] *Id.* at 18620.

collection requirements as defined by the PRA. No comments were received concerning the Commission's determination in this regard.

List of Subjects in 17 CFR Part 35

Commodity futures, Commodity options, Prohibited transactions.

In consideration of the foregoing, and pursuant to the authority contained in the Commodity Exchange Act, and in particular, sections 2, 4, 4c, and 8a, 7 U.S.C. 2, 6, 6c, and 12a, as amended, the Commission hereby adds part 35 of chapter I of title 17 of the Code of Federal Regulations as follows:

PART 35—EXEMPTION OF SWAP AGREEMENTS

Authority: 7 U.S.C. 2, 6, 6c, and 12a.

§ 35.1 Definitions

(a) *Scope.* The provisions of this part shall apply to any swap agreement which may be subject to the Act, and which has been entered into on or after October 23, 1974.

(b) *Definitions.* As used in this part:

(1) *Swap agreement* means:

(i) An agreement (including terms and conditions incorporated by reference therein) which is a rate swap agreement, basis swap, forward rate agreement, commodity swap, interest rate option, forward foreign exchange agreement, rate cap agreement, rate floor agreement, rate collar agreement, currency swap agreement, cross-currency rate swap agreement, currency option, any other similar agreement (including any option to enter into any of the foregoing);

(ii) Any combination of the foregoing; or

(iii) A master agreement for any of the foregoing together with all supplements thereto.

(2) *Eligible swap participant* means, and shall be limited to the following persons or classes of persons:

(i) A bank or trust company (acting on its own behalf or on behalf of another eligible swap participant);

(ii) A savings association or credit union;

(iii) An insurance company;

(iv) An investment company subject to regulation under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*) or a foreign person performing a similar role or function subject as such to foreign regulation, *provided* that such investment company or foreign person is not formed solely for the specific purpose of constituting an eligible swap participant;

(v) A commodity pool formed and operated by a person subject to regulation under the Act or a foreign person performing a similar role or function subject as such to foreign regulation, *provided* that such commodity pool or foreign person is not formed solely for the specific purpose of constituting an eligible swap participant and has total assets exceeding $5,000,000;

(vi) A corporation, partnership, proprietorship, organization, trust, or other entity not formed solely for the specific purpose of constituting an eligible swap participant (A) which has total assets exceeding $10,000,000, or (B) the obligations of which under the swap agreement are guaranteed or otherwise supported by a letter of credit or keepwell, support, or other agreement by any such entity referenced in this paragraph (b)(2)(vi)(A) of this section or by an entity referred to in paragraph (b)(2) (i), (ii), (iii), (iv), (v), (vi) or (viii) of this section; or (C) which has a net worth of $1,000,000 and enters into the swap agreement in connection with the conduct of its business; or which has a net worth of $1,000,000 and enters into the swap agreement to manage the risk of an asset or liability owned or incurred in the conduct of its business or reasonably likely to be owned or incurred in the conduct of its business;

(vii) An employee benefit plan subject to the Employee Retirement Income Security Act of 1974 or a foreign person performing a similar role or function subject as such to foreign regulation with total assets exceeding $5,000,000, or whose investment decisions are made by a bank, trust company, insurance company, investment adviser subject to regulation under the Investment Advisers Act of 1940 (15 U.S.C. 80a–1 *et seq.*), or a commodity trading adviser subject to regulation under the Act;

(viii) Any governmental entity (including the United States, any state, or any foreign government) or political subdivision thereof, or any multinational or supranational entity or any instrumentality, agency, or department of any of the foregoing;

(ix) A broker-dealer subject to regulation under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*) or a foreign person performing a similar role or function subject as such to foreign regulation, acting on its own behalf or on behalf of another eligible swap participant: *Provided, however,* that if such broker-dealer is a natural person or proprietorship, the broker-dealer must also meet the requirements of either paragraph (b)(2) (vi) or (xi) of this section;

(x) A futures commission merchant, floor broker, or floor trader subject to regulation under the Act or a foreign person performing a similar role or function subject as such to foreign regulation, acting on its own behalf or on behalf of another eligible swap participant: *Provided, however,* that if such futures commission merchant, floor broker, or floor trader is a natural person or proprietorship, the futures commission merchant, floor broker, or floor trader must also meet the requirements of paragraph (b)(2) (vi) or (xi) of this section; or

(xi) Any natural person with total assets exceeding at least $10,000,000.

§ 35.2 Exemption.

A swap agreement is exempt from all provisions of the Act and any person or class of persons offering, entering into, rendering advice, or rendering other services with respect to such agreement, is exempt for such activity from all provisions of the Act (except in each case the provisions of sections 2(a)(1)(B), 4b, and 4o of the Act and § 32.9 of this chapter as adopted under section 4c(b) of the Act, and the provisions of sections 6(c) and 9(a)(2) of the Act to the extent these provisions prohibit manipulation of the market price of any commodity in interstate commerce or for future delivery on or subject to the rules of any contract market), provided the following terms and conditions are met:

(a) The swap agreement is entered into solely between eligible swap participants at the time such persons enter into the swap agreement;

(b) The swap agreement is not part of a fungible class of agreements that are standardized as to their material economic terms;

(c) The creditworthiness of any party having an actual or potential obligation under the swap agreement would be a material consideration in entering into or determining the terms of the swap agreement, including pricing, cost, or credit enhancement terms of the swap agreement; and

(d) The swap agreement is not entered into and traded on or through a multilateral transaction execution facility;

provided, however, that paragraphs (b) and (d) of Rule 35.2 shall not be deemed to preclude arrangements or facilities between parties to swap agreements, that provide for netting of payment obligations resulting from such swap agreements nor shall these subsections be deemed to preclude arrangements or facilities among parties to swap agreements, that provide for netting of payments resulting from such swap agreements; *provided further*, that any person may apply to the Commission for exemption from any of the provisions of the Act (except 2(a)(1)(B)) for other arrangements or facilities, on such terms and conditions as the Commission deems appropriate, including but not limited thereto, the applicability of other regulatory regimes.

Issued in Washington, DC on January 14, 1993, by the Commission.

Jean A. Webb,

Secretary of the Commission.

[FR Doc. 93–1365 Filed 1–21–93; 8:45 am]

BILLING CODE 6351-01-M

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

18 CFR Part 284

[Docket Nos. RM90–7–003, CP93–111–000 and CP93–83–000]

Revisions to Regulations Governing Transportation Under Section 311 of the Natural Gas Policy Act of 1978 and Blanket Transportation Certificates; El Paso Natural Gas Company; Order No. 537–B

AGENCY: Federal Energy Regulatory Commission; Energy.

ACTION: Order clarifying final rule.

SUMMARY: Order No. 537–A, III FERC Statutes and Regulations ¶ 30,952 (September 21, 1992), 57 FR 46,496 (October 9, 1992), established a three-month time period, from September 21, 1992 to December 21, 1992, during which pipelines could seek authority under section 7 of the Natural Gas Act to operate facilities which has been constructed and were being operated under section 311 of the Natural Gas Policy Act of 1978. This order clarifies that if a pipeline applied, by December 21, 1992, for appropriate authorization but had not obtained the authorization by that date, it may continue to operate the facilities under the Natural Gas Act until the Commission has issued a final order on the pipeline's application, or the authorization automatically becomes effective under the provisions of section 157.205 of the Commission's regulations, if blanket authority is sought and no protest has been filed. On the other hand, if a pipeline has not applied for appropriate authorization to operate section 311 facilities under part 157 of the Commission's regulations within the three-month time period, its authority to operate said facilities pursuant to the exemption issued in the interim rule expired on December 21, 1992. In order to continue operating such facilities to provide section 7 services, a pipeline will have to apply to the Commission for authority to do so, and must demonstrate good cause for not having filed a timely application for permanent section 7 authority to operate such facilities.

EFFECTIVE DATE: January 14, 1993.

FOR FURTHER INFORMATION CONTACT: Amy R. Heyman, Office of the General Counsel, Federal Energy Regulatory Commission, 825 North Capitol Street NE., Washington, DC 20426 (202) 208–0115.

SUPPLEMENTARY INFORMATION: In addition to publishing the full text of this document in the **Federal Register**, the Commission has made this document available so that all interested persons may inspect or copy its contents during normal business hours in room 3308, 941 North Capitol Street NE., Washington, DC, 20426.

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Before Commissioners: Martin L. Allday, Chairman; Charles A. Trabandt, Elizabeth Anne Moler, Jerry J. Langdon and Branko Terzic.

El Paso Natural Gas Company

Issued January 14, 1993.

On December 17, 1992, El Paso Natural Gas Company (El Paso) filed a motion for an extension of the time provided in Order No. 537–A,[1] for pipelines to obtain certificate authority under section 7(c) of the Natural Gas Act (NGA) to operate facilities previously constructed and operated under section 311 of the Natural Gas Policy Act of 1978 (NGPA).[2] Since El Paso raises an issue which other similarly situated pipelines may raise with regard to the time period provided for in Order No. 537–A, we will clarify that order so that other pipelines will not be required to file similar requests with the Commission.

Background

On September 20, 1991, the Commission issued Order No. 537,[3] a final rule revising the regulations governing transportation by interstate pipelines under section 311 of the NGPA. On September 21, 1992, the Commission issued an order on rehearing of the final rule, Order No. 537–A.[4] In Order No. 537–A, the Commission acknowledged that the final rule should have provided for a reasonable time period during which interstate pipelines could seek authorization under the NGA to operate facilities previously constructed and operated pursuant to authority under section 311 of the NGPA.

This issue arose because contemporaneously with the issuance of the Notice of Proposed Rulemaking in Docket No. RM90–7–000, which proceeding resulted in the issuance of Order Nos. 537 and 537–A, the Commission issued two interim rules. The first, in Docket No. RM90–13–000, provided a time period during which pipelines and shippers could convert non-qualifying section 311 transactions to transactions authorized under section 7 of the NGA.[5] The second, in Docket No. RM90–14–000, exempted from the requirements of section 7 of the NGA the operation of facilities constructed under section 311 of the NGPA, but utilized to provide services converted from section 311 to section 7 authorization.[6] This interim rule also stated that, if necessary, the Commission would prescribe in the final rule in Docket No. RM90–7–000 a reasonable time period within which pipelines could seek permanent authority under section 7 of the NGA to operate facilities constructed and operated under section 311, but utilized

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[1] Revisions to Regulations Governing Transportation Under section 311 of the Natural Gas Policy Act of 1978 and Blanket Transportation Certificates, Order 537–A, 57 FR 46496 (October 9, 1992), FERC Stats. & Regs. ¶ 30,952 (1992).

[2] 15 U.S.C. 3301–3432 (1988).

[3] Revisions to Regulations Governing Transportation Under Section 311 of the Natural Gas Policy Act of 1978 and Blanket Transportation Certificates, 56 FR 50235 (October 4, 1991), FERC Stats. & Regs., Regs. Preambles, ¶ 30,927 (1991).

[4] See *supra* note 1.

[5] Interim Revisions to Regulations Governing Transportation Under Section 311 of the Natural Gas Policy Act of 1978 and Blanket Transportation Certificates. FERC Stats. & Regs., Reg. Preamble (1986–1990), ¶ 30,894, *amended*, FERC Stats. & Regs. Preambles (1986–1990), ¶ 30,899, *reh'g denied*, 53 FERC ¶ 61,141 (1990).

[6] Interim Revisions to Regulations Governing Construction of Facilities pursuant to NGPA section 311 and Replacement of Facilities, 55 FR 33011 (August 13, 1990), FERC Stats. & Regs. ¶ 30,895 (1990) at note 2.

to provide transportation services under the NGA. However, as noted above, such a period was not prescribed until Order No. 537–A was issued.

Although many pipelines had already applied for and obtained authority under section 7 of the NGA to operate facilities formerly operated under section 311 of the NGPA by the time Order No. 537 issued, others had not. Therefore, on rehearing of Order No. 537, certain parties requested clarification regarding the time period during which pipelines still requiring section 7 authorization could apply for it. Order No. 537–A provided that pipelines which had not yet sought section 7 authority to operate their facilities could do so within three months of the date Order No. 537–A issued. Order No. 537–A issued on September 21, 1992; therefore, the three-month period expired on December 21, 1992.

El Paso's Request for an Extension of Time

On November 27, 1992, in Docket No. CP93–83–000 and on December 15, 1992, in Docket No. CP93–111–000, El Paso filed prior notice requests in order to obtain permanent authority to operate certain facilities under its blanket facilities certificate pursuant to part 157, subpart F, of the Commission's regulations. The facilities in question had been constructed and were being operated pursuant to section 311 of the NGPA. El Paso states in its request for an extension of time that the authority it seeks may not be granted within three-month time period provided for in Order No. 537–A. Therefore, El Paso seeks an extension of time in which it may continue to operate the facilities in question pursuant to the exemption issued in the interim rule in Docket No. RM90–14–000.

Clarification

In Order No. 537–A, the Commission referred to a three-month time period during which pipelines could seek authority under the NGA to operate facilities which had been constructed and were being operated under section 311 of the NGPA. The Commission also stated that to the extent authority had not been obtained within the three-month time period, it would consider extensions of time on a case-by-case basis.

We clarify that if a pipeline has applied for appropriate authorization under the NGA to operate section 311 facilities within the three-month time period, *i.e.*, by December 21, 1992, but has not obtained the authorization within that time frame, the exemption issued in the interim rule in Docket No. RM90–14–000 will continue until the Commission has issued a final order on the pipeline's application, or the authorization automatically becomes effective under the provisions of section 157.205, if blanket authority is sought and no protest has been filed. In such situations, an extension of the three-month time period is unnecessary. Since El Paso applied for authorization within the three-month time period, its authority to operate the section 311 facilities, as provided in the interim rule, will continue until the automatic authorization sought becomes effective or the Commission rules on its application. Therefore, we will deny El Paso's request for an extension of time.

On the other hand, if a pipeline has not applied for appropriate authorization to operate section 311 facilities under Part 157 of the Commission's regulations within the three-month time period, its authority to operate said facilities pursuant to the exemption issued in the interim rule expired on December 21, 1992. In order to continue operating such facilities to provide section 7 services, a pipeline will have to apply to the Commission for authority to do so, and must demonstrate good cause for not having filed a timely application for permanent section 7 authority to operate such facilities.

The Commission Orders

(A) Order No. 537–A is clarified to the extent discussed herein.

(B) El Paso's request for an extension of time is denied.

By the Commission.

Lois D. Cashell,

Secretary.

[FR Doc. 93–1498 Filed 1–21–93; 8:45 am]

BILLING CODE 6717–01–M

DEPARTMENT OF THE TREASURY

Customs Service

19 CFR Parts 118, 151 and 178

RIN 1515–AB10

[T.D. 93–6]

Centralized Examination Stations

AGENCY: Customs Service, Department of the Treasury.

ACTION: Final rule.

SUMMARY: This document amends the Customs Regulations to set forth a regulatory framework for the establishment, operation and termination of Centralized Examination Stations (CESs). A CES is a privately operated facility at which imported merchandise is made available to Customs officers for physical examination. These regulatory amendments will allow Customs to better use its inspectional resources and clear higher volumes of cargo.

EFFECTIVE DATE: February 22, 1993.

FOR FURTHER INFORMATION CONTACT: Patricia Duffy, Office of Inspection and Control (202–927–1344).

SUPPLEMENTARY INFORMATION:

Background

In recent years there has been a significant increase in the number of Container Freight Stations (CFSs), bonded warehouses, truck and rail terminals, and other facilities which receive and hold imported cargo for purposes of examination and clearance by Customs. As a result of this increase, and due to the fact that these facilities often are not in close proximity to each other within a given port of entry, Customs inspectors have had to spend a greater proportion of their time traveling from one location to another in order to perform cargo examinations necessary to ensure compliance with the law. This increase in travel time has had a negative effect on Customs productivity, has complicated Customs efforts to properly allocate personnel to meet its workload, and has had a corresponding negative effect on Customs ability to render efficient clearance and related services to the importing community.

The Centralized Examination Station (CES) program was developed by Customs in order to address the problems outlined above. A CES is a privately operated facility at which imported merchandise identified by Customs for physical examination is made available to Customs inspectors for that purpose. Once Customs identifies merchandise for examination, the importer or the importer's agent is responsible for selecting the CES to be used (where there is more than one CES within the port and unless the District Director of Customs has reason to make the selection), for arranging the bonded transfer of the merchandise to the CES, and for paying the costs of the transfer as well as any fees charged by the CES facility for its services. The services which the CES operator renders are for the benefit of the importer (who is required under law to make the imported merchandise available to Customs for inspection) and involve storage of the merchandise under bond and with liability insurance, opening the container in which the merchandise